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New economic legislation, 2001–2002

This issue features our regular annual evaluation of changes in economic legislation that occurred over the past year, and of the impact they had on the business environment in Ukraine. The lack of a common vision regarding public policy in the Verkhovna Rada, and the government's failure to provide analytical support for policy, prevented a number of laws from being adopted that would have been important for the business community (e.g., the Civil Code, tax laws). Entrepreneurs have no possibility to forecast legislative developments, and thus are prevented from designing or implementing their own long-term development strategy. Among the positive results achieved this year, we can cite the adoption of the Land and Customs codes, as well as improvements made to financial and judicial legislation.

november 2002

international centre for policy studies

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Overview

This issue of* POLICY STUDIES *features our regular annual evaluation of changes in economic legislation that occurred between October 2001–November 2002, and of the impact they had on the business environment in Ukraine.[1] The lack of common vision regarding public policy in the Verkhovna Rada, along with the government's failure to provide analytical support for policy, prevented a number of laws from being adopted that would have been important for the business community (e.g., the Civil Code, tax laws). Entrepreneurs have no possibility to forecast legislative developments, and thus are prevented from designing or implementing their own long-term development strategy. Among the positive results achieved this year we can cite the adoption of the Land and Customs codes, as well as improvements made to financial and agricultural legislation

During October 2001–November 2002, the Ukrainian government adopted inconsistent normative acts in its effort to regulate certain market relations. However, framework legislation adopted under the centrally planned economy regime (namely, the 1963 Civil Code, 1970 Punitive and Labour Code, 1971 Code of Labour Laws, 1983 Housing Code, and 1984 Code of Administrative Offenses, 1991 Economic Procedural Code) were not superseded. The President of Ukraine vetoed new Civil and Economic codes, which were to be enacted starting on 1 January 2003 (see **OWNERSHIP RELATIONS**). We believe it would be advisable to finalise and adopt the Economic Code, in view of the changes narrowing the sphere of state interference. Concurrently, the Verkhovna Rada should focus its efforts on elaborating and adopting a new Civil Code.

The current outdated legislation in Ukraine fails to rise to today's market needs, and often contradicts new normative and legal acts. Under such circumstances, legislative uncertainty has increased, particularly in terms of protecting private ownership rights; and as a result, the risks of doing business escalate. Furthermore, obsolete laws stifle the development of new financial instruments.

During this period, no systemic changes took place in terms of legislation on corporate governance; the Verkhovna Rada has not yet approved a new Law of Ukraine "On joint-stock companies". Meanwhile, only fragmentary changes have been made to the legislation regulating this sphere (see **OWNERSHIP RELATIONS**). We believe that such a situation is due to the fact that national industrial and financial groups have sought to preserve non-transparent rules, since such conditions permit them to gain control over enterprises at a lower price.

None of the necessary legislative changes have happened in the state property management sector. Laws "On the management of state property" and "On the State Property Fund of Ukraine" have not been adopted, even though they could perceptibly boost the quality of state property management.

At the same time, reform of the judiciary has been undertaken; on 7 February 2002, the Verkhovna Rada adopted a new Law of Ukraine "On the judiciary in Ukraine", which super-

[1] For further information regarding changes in Ukraine's economic legislation starting from 1998, see **POLICY STUDIES**, nos. 8 (July–August 1999), 12 (December 2000), and 16 (October 2001).

seded the laws "On the judiciary", "On commercial courts", and "On bodies of judicial self-government" (see **Judicial reform**). The law sets forth the legal frameworks to organise judicial bodies and administer justice; boosts the specialisation of courts and judges, which will provide for the more competent review of cases; and regulates the procedures for supporting court activities, which will give them more independence and thus enhance the protection of entrepreneurs' rights. However, the effects of these judicial reforms will only be revealed with time.

Tax system reform in Ukraine was cramped by the opposition between taxpayer and government interests; businessmen first of all seek to alleviate their tax burden, while the government endeavours to keep budget revenues from any sizable shrinking (see **Tax policy**). The Verkhovna Rada failed to pass the Tax Code; instead, certain tax laws were considered, with the Law of Ukraine "On the corporate profit tax" amended (the tax rate was cut, depreciation norms raised, and administration simplified) and the excise rate for certain commodities raised.

Table 1. Summary evaluation of changes in Ukrainian economic legislation

Changes stimulating business	Changes hampering business
– mitigation of the tax burden on enterprises in the new version of the Law of Ukraine "On the corporate profit tax" (decreased corporate profit tax rate, increased depreciation norms, simplified administration)	– accumulated VAT reimbursement debts to exporters, making it even more unpredictable to do business in Ukraine and putting exporters on unequal footing
– demonopolised market for confirming compliance services	– abandoning single licensing procedures, which tightened administrative pressure over business
– adoption of framework laws on insurance and credit unions, and formation of financial market regulation agencies, which fostered the institutionalisation of the non-banking financial sector	– delaying the creation of an authorised executive body to regulate the financial services market, which stalled the development of the non-banking financial sector
– regulation of the activity of joint investment institutions (mutual funds), which permitted to start granting licenses to asset-managing companies	– uncertainty in the adoption of a new version of the Civil Code, which was detrimental to the investment climate and the protection of private ownership rights
– adoption of a new Customs Code, which will allow to curtail operating costs for agents of external economic activity thanks to simplified and more transparent customs procedures	– delaying the adoption of the law on money laundering which resulted in the FATF imposing counter-measures
– approval of the Land Code, which heralds the formation of a free land market	– approval of decisions to support agriculture that are not backed by budget financing
– unlimited employment term for foreigners, which lowered barriers to labour migration	

Source: International Centre for Policy Studies.

However, the effects from these changes will be felt no earlier than 2004. In November 2002, the process of amending legislation on personal income taxation was initiated—the Verkhovna Rada passed in first reading a relevant law envisaging mitigation of the tax burden upon Ukrainians.

The government's policy aiming to support entrepreneurship was for the most part declarative (see **Regulation of economic activity**). The number of adopted normative and legal acts that would simplify the regulation of entrepreneurial activity was insufficient. In the meantime, administrative and normative pressure upon entrepreneurs has hardly abated. We believe that the excessive number of normative and legal acts passed every year[2] is the virtual equivalent of an administrative tax on business, since they consume extra time and money of entrepreneurs in their efforts to track all the changes in the legal domain. Intricate and frequent changes in the legal domain are one of the key problems for doing business in Ukraine.

The Verkhovna Rada and Cabinet of Ministers of Ukraine hardly undertook any measures to adjust Ukrainian legislation to the norms of the World Trade Organisation (WTO; see **Open economy**). The chief accomplishments became the adoption of the new Customs Code, the Law of Ukraine "On the particulars of state regulation of economic entities' activity related to the production, export, import of CDs for laser data-reading systems", and amendments to the Law of Ukraine "On the quality and safety of foodstuffs and food raw material". Furthermore, in its desire to tighten protectionism of the national automobile and ferrous metallurgy industries, the Verkhovna Rada adopted laws contradictory to WTO norms. We believe that this was possible due to (1) the disinterest of influential stakeholders in acceding to this organisation; and (2) the lack of a mechanism for monitoring conformity of draft laws and governmental decisions to WTO norms.

A positive achievement of the market's openness to labour migration became the lifting of all restrictions on employment terms for foreigners and stateless individuals in Ukraine. On the other hand, an earlier decision of the Constitutional Court regarding changes to the requirement of registering/terminating the domestic residence permit—i.e., from "by permission" to "optional/voluntary"—has remained only declarative,[3] since Ukrainians are still asked to show a stamp in their passport indicating permanent residence when concluding acts of civil registry.

The most important legislative changes in the financial sector had to do with the regulation of activity of non-banking institutions (see **Financial sector**). During this period, the Verkhovna Rada passed the following key laws: "On credit unions" and "On amending the Law of Ukraine 'On insurance'". Nonetheless, delaying the creation of the State Commission on Financial Services Market Regulation has stifled the development of the non-banking financial sector.

In addition, the Ukrainian government undertook measures to cope more efficiently with money laundering; the Verkhovna Rada adopted the Law of Ukraine "On the prevention and counteraction of legalisation (laundering) of incomes acquired by criminal means", while the NBU tightened its control over foreign subsidiaries of Ukrainian banks. However, despite the measures undertaken, the FATF classified Ukraine as

[2] Over three thousand laws, Presidential decrees, and governmental resolutions alone are adopted annually. There are even more normative and legal documents of departments and local government bodies.

[3] See the Decision of the Constitutional Court of Ukraine dated 14 November 2001 regarding the compliance of the Constitution of Ukraine (constitutionality) of the provision of sub-clause 1 of clause 4 of the Provision on the passport authority of the internal affairs institutions.

a country not cooperating in combating money laundering.

During October 2001–November 2002, the Land Code was a hugely important legislative act in agriculture approved by the Verkhovna Rada (see **Agriculture**). Its adoption heralds the creation of a new free land market, which will transform land into capital. Nonetheless, the Ukrainian government has still to promulgate a great number of normative and legal acts required by the code; this makes it highly unlikely that a free land market will emerge before 2005.

The Ukrainian government resorted to a number of measures to support agriculture during the evaluated period, including the introduction of obligatory crop insurance. We disapprove of this measure, since we believe that it discourages enterprises from independently diversifying risks and can unreasonably drive up their expenses. Another mechanism introduced to support grain prices at a stable level was pledged and interventionary purchases. However, given that the budget does not allocate any money to finance these mechanisms, they are only declarative at this point.

Major problems in the communications sector include the lack of mechanisms to finance social needs and non-regulated interaction between operators (see **Communications**). Postponing the resolution of these problems will result in: (1) escalating opposition between the Ukrtelekom OJSC and private operators; and (2) a sluggish pace for the development of the telecommunications network and telephone penetration level. Therefore, all market participants should be interested in the adoption of a new Law of Ukraine "On telecommunications". Indeed, the Verkhovna Rada has registered such a draft, which entails its attempt to adjust the activity of this corresponding sector in Ukraine to comply with European Union directives. However, vaguely defined norms of the draft can spawn rent seeking and increase providers' operating costs, as well as administration expenses on the part of the government.

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The research was conducted with financial support from the Centre for International Private Enterprise (CIPE, Washington, DC) under the framework of the "Evaluation of Changes in Economic Legislation" project. The research employed results of enterprise opinion polls carried out in 2002 by the Ukrainian Marketing Group, commissioned by the International Finance Corporation.[4]

The above experts and CIPE specialists are not responsible for the estimates and opinions expressed in this paper.

[4] "Ukraine: An Assessment of the Business Enabling Environment" (October 2002).

Ownership relations

Over October 2001–November 2002, no systemic changes occurred in legislation on corporate governance due to the Verkhovna Rada's failure to pass a new Law of Ukraine "On joint-stock companies", legislation regulating this sphere underwent only fragmentary changes. The situation was similar in the state property management sector, with no adoption of the laws "On the management of objects of state ownership" and "On the State Property Fund of Ukraine", which could have boosted the quality of state property management significantly. The President of Ukraine vetoed new Civil and Economic codes, which were to come into effect starting on 1 January 2003. We believe it would not be expedient to revise or adopt the Economic Code, given that the scope of state interference has been narrowed. At the same time, the Verkhovna Rada should focus its efforts on revising and adopting a new version of the Civil Code

Corporate governance

Over October 2001–November 2002, the Verkhovna Rada made only fragmentary changes to legislation on corporate governance, which were induced by the crucial need to adjust certain legislative norms to accepted corporate relations practice. The main laws adopted by the parliament during the research period were the laws dated 7 March 2002 "On amending the Law of Ukraine 'On restoring debtors' solvency or declaring them bankrupt'" and "On amending the Law of Ukraine 'On companies'". These documents (1) eliminated the unanimity requirement during voting, replacing it with simple-majority voting; and (2) banned the holding shareholders' meetings abroad, with the exception being if all shareholders are non-residents.

However, no systemic changes were undertaken in corporate governance legislation that might allow to do away with the inconsistencies between different laws; symptomatically, a new Law of Ukraine "On joint-stock companies" was not approved. We believe that this situation was due to the tendency of national industrial and financial groups to stick to non-transparent rules, since that gives them the chance to gain control over enterprises at a lower price.[5]

The Decree of the President of Ukraine dated 21 March 2002 "On measures to develop corporate governance in joint-stock companies" sets forth the following radical changes in corporate governance legislation:

- establishing a cumulative voting procedure in the course of forming supervisory boards;
- determining cases of mandatory buyouts of shareholders' stakes by companies at market prices;
- introducing mandatory notification of intent to purchase controlling share packages of corresponding companies and determining the procedure for issuing such a notification;

[5] This explains low domestic demand for shares of national enterprises, with low liquidity of the stock fund being the proof.

- establishing administrative responsibility of company officials for violating shareholders' rights.

We assume that the process of adopting necessary legislation will galvanise as the 2004 presidential elections approach, prior to which financial and industrial groups will seek to legislatively shield their ownership rights in order to insure themselves against undesirable implications in case of property re-distribution.

Civil Code

In Ukraine, the Civil Code adopted back in 1963 is still in effect. Its norms do not fit market economy conditions, because it does not take into account the rights of private business. The issue of forming and functioning of private enterprises has been regulated by other normative documents, particularly the laws "On property" and "On enterprises in Ukraine". Nonetheless, when considering cases courts continue to be guided by the provisions of the passé Civil Code, which hampers the effective protection of private ownership rights.

On 29 November 2001, the Verkhovna Rada passed at one sitting the Civil and Economic codes. Under the laws promulgating them, both codes were to come into effect starting on 1 January 2003. However, the President of Ukraine vetoed them and insisted on a more thorough elaboration of both documents, and an incorporation of his proposals.

The President believes that the key obstacles to enforcing the Economic and Civil codes are the following:

- The Civil and Economic codes have certain regulation issues in common, but their ways of regulating the same relations differ;
- Norms of both codes contradict the Constitution of Ukraine.

Inconsistency between the Civil and Economic codes. The objects of regulation by the Civil Code are personal non-property and property relations. The norms of the Civil Code should be applied to legal entities of both private law and public law, if they enter into civil relations. Therefore, the Civil Code does not regulate relations within public law (particularly those grounded upon administrative or other authoritative subordination of one party to another). The Economic

How to prevent obstacles to the activities of joint-stock companies

The Supreme Court of Ukraine and the Higher Commercial Court of Ukraine are guided by various legislative acts on corporate governance in joint-stock companies. The Supreme Court is governed mostly by the general legislation, such as the obsolete Civil Code, and disregards normative acts more in keeping with the situation in the market (especially those adopted by the State Commission on Securities and the Stock Market). Given the failure of the judicial system to achieve sufficient independence and lack of bias (see **Judicial reform***), it is getting possible for certain shareholders to block decisions of joint-stock companies by certain shareholders, based on the following scheme:[6] the covert claimant (1) finds an individual residing in a district where the local court is "on side"; (2) helps him/her to become a petty shareholder; (3) directs this shareholder to file a claim prepared by the lawyers of the covert claimant (the cost of the claim is only 8.5 UAH); and (4) the court makes the required ruling (more rarely, a decision). We believe that in order to prevent the activities of joint-stock companies from being blocked, the primary task should be to increase the independence of the judicial system and raise the level of court specialisation (see* **Judicial reform***).*

[6] Such a scheme is most frequently used when it is needed to arrest property or some amount of money, or to disrupt shareholders' meetings (e.g., to block decisions about extra issues of shares). Over the evaluated period, such schemes were especially practiced by the Darnytsia CJSC in its conflict with the Borschahivsky Chemical and Pharmaceutical Plant JSC.

Code regulates economic relations arising when organising and conducting economic activity between economic agents, as well as between these agents and other parties involved in the economic sphere. Thus, the Economic Code regulates both public-law and private-law relations.

Concurrently, both codes, as already mentioned, regulate the same relations in a different fashion. For instance, they give different classifications of entrepreneurial entities and envisage different procedures for their creation.

Thus, the simultaneous promulgation of both codes will give rise to a great number of legal collisions, which will obstruct the work of government bodies and courts, and will significantly increase enterprises' operating costs. What is more, the Economic Code incorporates a number of norms contradicting extant legislation—that is, norms on the protection of economic competition (regulated by the Law of Ukraine "On the protection of economic competition"), and on the regulation of land and budget relations (regulated by the Land and Budget codes).

Inconsistency of code norms with the Constitution of Ukraine. According to the President, incongruity of the Economic Code with constitutional norms exists in the following areas:

- The Economic Code regulates those relations which according to the Constitution should be guided solely by laws of Ukraine, including the designation of spheres of state regulation and lists of types of activity/entrepreneurship where competition rules and norms of antimonopoly regulation are not applied;
- Classifies the Cabinet of Ministers, ministries, and other governmental bodies and organisations as management bodies of the state sector of the economy, while in the Constitution only the Cabinet of Ministers falls under this category;
- Contrary to the Constitution, it does not permit appeals against the actions or negligence of government and local self-government bodies;
- Envisages that communal property is to be managed by local self-government bodies. At the same time, the Constitution stipulates that territorial communities are to be in charge, either directly or through established local self-government bodies.

As for the Civil Code, the President focuses attention to the following key areas of its inconsistency with the Constitution of Ukraine:

- The code restrains the President's constitutional authorities, particularly the right to limit human rights and freedoms in emergency situations, and the right to issue decrees and directives;
- Contradictions over ownership rights of the Autonomous Republic of Crimea, with the code stipulating the ownership rights of the republic, while the Constitution defines only the right to manage property belonging to the republic.

We consider the elaboration and adoption of the Economic Code to be inexpedient, in view of the scope of state interference having been narrowed. Under the market economy, only a limited number of oblasts remain that necessitate state interference in enterprise activities, as follows:

- regulation of natural monopolies (energy sector, railway transport, housing and public utilities, and communications);
- protection of economic competition and prevention of abuses of monopoly status;
- guaranteed safety of consumption and effective allocation of limited natural resources (licensing, standardisation, certification);
- environmental protection.

We believe that in order to regulate these areas, it would be sufficient to adopt specific laws, some of which have already been enacted in Ukraine. Relations between the government and state-owned enterprises should be governed by corporate governance mechanisms (charter approval, appointment of managers, reporting procedures for managers).

At the same time, we believe that the Verkhovna Rada should focus its efforts on revising and adopting the Civil Code. This will allow the further development of Ukraine's legislation, and the adoption of the laws of Ukraine "On joint-stock companies" and "On securities and the stock exchange". The implementation of a new Civil Code is expected to ameliorate the investment climate in Ukraine and boost the protection of private ownership rights.

State property management

The overriding problem in state property management in Ukraine is low management performance, due to feeble incentives for state managers to efficiently perform their duties. Over October 2001–November 2002, the Verkhovna Rada failed to pass the laws of Ukraine "On the management of state property objects" and "On the State Property Fund of Ukraine", which could substantially boost the quality of management. Currently, the SPFU continues to operate on obsolete legal foundations dating to 1991–1992,[7] where its authorities are vaguely defined.

Meanwhile, government policy in the state management sphere boiled down to performing minor legislative changes over the research period. In particular, on 7 November 2001 the President issued the Decree "On immediate measures to regulate the activity of state (national) joint-stock and holding companies", which proved almost fruitless. Among its positive achievements, it is only to mention the prohibition on alienating shares transferred to share capital, the liquidation of the Credit and Guarantee Institution, and the limitation of operations by state-controlled enterprises involving bills of exchange (however, enterprises of the oil-and-gas complex and electricity enterprises were left out of its purview).

Furthermore, the process of state property management remained behind an informational screen. An example of non-transparent state property management policy is the Cabinet of Ministers of Ukraine resolution dated 1 March 2002 "On the transfer of 100 percent of shares of the Komsomolske Rudoupravlinnia open joint-stock company, which is a part of the share capital of the Ukrrudprom State Joint-Stock Company, to the management of the Mariupol Illich Metallurgical Works open joint-stock company". The transfer was performed non-competitively.

In addition, over the research period, the post-privatisation sale took place of energy-generating companies, ore refineries, an oil export terminal, and a tyre-manufacturing enterprise. The Verkhovna Rada adopted the Law of Ukraine dated 29 November 2001 "On declaring a moratorium on forced property sales", prohibiting the alienation of state property and state corporate rights in exchange for outstanding debts. However, we believe that this Law does not resolve the problem of low management performance, since it: (1) reduces the responsibility of managers of state-controlled enterprises and heaps more debts upon many enterprises; (2) creates unequal conditions for entrepreneurial activity; and (3) limits the possibilities of state enterprises to obtain loans.

Most Ukrainian enterprises were privatised in the year 2000—only enterprises of infra-

[7] See the Cabinet of Ministers of the Ukrainian Soviet Socialist Republic resolution dated 19 August 1991 "Concerning the State Property Fund of the Ukrainian SSR" and the Verkhovna Rada of Ukraine Resolution dated 7 July 1992 "On the Temporary Regulations on the State Property Fund of Ukraine".

structure sectors remained state-owned. The sales of energy-distributing enterprises in April 2001 testified once more that the privatisation of infrastructure enterprises demands far greater efforts in view of the need to distinguish between the social and commercial functions of such enterprises, as well as to establish market regulations in these sectors.

We are of the opinion that government policy regarding infrastructure enterprises should strive to achieve the following goals:

- to clearly distinguish between the social and commercial functions of said enterprises;
- to organise commercial activity so as to maximise profits, and to adopt the best practices and organisational structures in order to accomplish this goal;
- to find a viable mechanism for financing social goals and controlling their accomplishment;
- to supply the necessary funds for new investments;
- to ensure the largest possible revenues to the budget from said enterprises.

Judicial reform

The second step in the reform of the judicial system[8] was approved with the passage of the 7 February 2002 Law of Ukraine "On the judiciary of Ukraine", which replaced a number of old laws. The law sets forth legal principles for the organisation of the judicial bodies and for the administration of justice; boosts specialisation of judges and court, which will allow to consider cases more competently; regulates the procedures for supporting judges' activities, which will make them more independent

In any country, effective protection of the interests of enterprises and organisations is impossible without an effective judicial system. A judicial system can be considered effective if it is capable of settling any dispute between economic entities or other parties professionally and without bias over a short period of time.

Currently, Ukraine's judicial system is undergoing reforms. The second step in the reform of the judicial system[8] was the approval on 7 February 2002 of a new Law of Ukraine "On the judiciary of Ukraine", which replaced a number of laws, namely, "On the judiciary", "On commercial courts", "On bodies of judicial self-government", and "On qualificatory committees, qualificatory attestation, and disciplinary responsibility of judges of courts of Ukraine". The new law regulates the following key issues pertaining to the functioning of Ukraine's judicial system:

- establishes the legal principles for the organisation of the judicial arm of government and for the administration of justice;
- establishes the system of courts of general jurisdiction;
- sets requirements for forming a body of professional judges, public assessors, and juries;
- regulates the procedure for exercising judicial self-government and ensuring the proper functioning of courts.

Courts of general jurisdiction

According to the law, Ukraine's judicial system is composed of courts of general jurisdiction and the Constitution Court of Ukraine. The courts of general jurisdiction are the following: local courts; courts of appeal; the Appeal Court of Ukraine; the Cassation Court of Ukraine; higher specialised courts; and the Supreme Court of Ukraine.

Appeal and Cassation courts

The Appeal and Cassation courts are new to Ukraine's judicial system.[9] They have been created in order to ensure proper fulfilment of citizens' rights to file appeals and cassation claims regarding court judgements. However, these courts are not working in

[8] At the first stage of the judicial reform, the Verkhovna Rada approved in June–July 2001 amendments to the Laws of Ukraine "On the judiciary", "On the status of judges", "On bodies of judicial self-government", "On the public prosecutor's office", "On the arbitration court", and "On the militia", as well as amended the procedural codes. For the evaluation of these legislative changes, see **Policy Studies**, No. 16 (October 2001), p. 23-24.

[9] Under the law the Appeal and Cassation Courts of Ukraine had to be formed till 7 August 2002. However, this was done only on 1 October 2002 by the Presidential Decree of Ukraine "On the Appeal Court of Ukraine, the Cassation Court of Ukraine, and the Supreme Administrative Court of Ukraine."

full capacity yet, due to the lack of necessary legislative acts; in particular, it has still not been determined what cases exactly are to be under the jurisdiction of the Appeal and Cassation courts of Ukraine.

Specialisation of courts and judges

Innovations brought by the Law of Ukraine "On the judiciary of Ukraine" in the domain of specialisation of courts and judges are the following:

- Establishment of specialised administrative courts. However, the categories of cases to be under the jurisdiction of these courts has not been determined yet. Given that three years were allotted to form the administrative court system, we expect that it will be fully formed no earlier than early 2005;
- Introduction of judge specialisation for the consideration of specific categories of cases.

We believe that specialisation in a specific category of cases (e.g., consideration of disputes between taxpayers and tax agencies, bankruptcy cases) allows judges to learn more profoundly and in more detail all legislative the nuances associated with such cases, and thus to perform their duties more competently.

Public assessors and juries

In order to comply with the requirements of the Constitution of Ukraine on ensuring the direct participation of the public-at-large in administering justice, the Law of Ukraine "On the judiciary of Ukraine" stipulated requirements regarding public assessors and juries, the procedure for their involvement in administering justice, as well as their rights and a guarantee of their protection. Public assessors are to be involved, and juries formed, in the consideration of court cases determined by the procedural law.

However, currently only the Criminal and Procedural Code envisages the involvement of public assessors to consider court cases, whereas the formation of juries is not envisaged by any procedural law. In order to ensure the effective introduction of the institution of public assessors and juries, new procedural codes will have to be adopted, or amendments entered into extant codes.

Ensuring proper functioning of the courts

The Law of Ukraine "On the judiciary of Ukraine" reforms the system of supporting court activity, with the following new features:

- a separate expenditures item in the State Budget to finance the courts to at least a minimum level ensuring the full and independent administration of justice, in accordance with the law;
- legislative guarantees of full and timely financing of the courts;
- guarantees of an appropriate level of social security for judges.

The National Court Administration, established by the Decree of the President dated 29 August 2002 "On the National Court Administration", ensures the organisational support for court activities, and as of 2003 it will be in charge of allocating State Budget funds earmarked to financially support the activities of all courts of general jurisdiction,[10] as well as the activities of expert committees of the courts of all levels, bodies of

[10] Excluding the Supreme Court of Ukraine, the Constitution Court of Ukraine, and high specialised courts.

judicial self-government, and the state judicial administration.

The National Court Administration performs no regulatory functions, nor creates or manages state enterprises—unlike the Ministry of Justice of Ukraine, which had heretofore been providing organisational, material, and financial support for court activities. Therefore, conflicts of interest in the National Court Administration should not arise in the process of supporting court activities. Given the above, we believe that the new procedure for supporting court activities should promote the independence and impartiality of the judicial arm of government.

Nevertheless, the lack of criteria for determining the proper level of financing for the courts and the responsibility for delayed or incomplete financing reduces the probability that requirements for supporting the courts will be fulfilled.

Tax Policy

Over October 2001–November 2002, no dramatic changes occurred in tax legislation. The key obstacle to consistent reforms in the tax system is the lack of compromise between taxpayers and the government, with business seeking above all to mitigate their tax burden while the government seeks to prevent the significant curtailment of budget revenues. A consensus was reached only regarding changes in the corporate profit tax approved in December 2002

Despite the fact that tax reform in Ukraine has been debated over four years, no coherent regulation in this sphere has been achieved so far. Due to the lack of radical legislative changes, the non-reformed tax system has become a serious factor curbing economic growth in Ukraine.[11]

We believe that the major obstacle to meaningful tax system reform is the lack of a compromise between taxpayers and the government, with business seeking above all to mitigate their tax burden while the government seeks to prevent the significant curtailment of budget revenues. In our opinion, if there is no substantial cut in the effective tax rate, any changes in the tax system will not noticeably stir up economic growth.[12] Therefore, of the two alternatives of either dramatically curtailing the tax rate or preserving budget revenues, it would be expedient to opt for the first option and trim current budget spending.

Corporate profit tax

An example of the incompatibility of government and business positions in Ukraine is well illustrated by the history of corporate profit tax reform.

In our opinion, this tax does require reform, in view of the following factors:

- The high tax rate, together with high business risks, makes long-term investments unprofitable;
- Low norms for depreciation deductions hamper investments, since they envisage unrealistically long terms for the usage of capital assets. Tax pressure is also intensified by the ban on deducting certain groups of expenditures from aggregate income[13] when paying taxes;
- The necessity of making monthly advance payments raises high, non-productive expenditures on accounting and complicates the planning of financial flows.[14]

[11] According to the results of an enterprise opinion poll conducted by the International Finance Corporation in 2002, the biggest problems with the taxation system were named by entrepreneurs as the size of tax rates, shaky tax legislation, and the number of taxes.

[12] According to a survey conducted by ICPS experts, the tax reductions envisaged in the last version of the Tax Code, would bring GDP growth up by only 0.6 percentage points (all other conditions being equal). For more details on the survey, see **Quarterly Predictions**, No. 21 (October 2002), p. 15–16.

[13] That is, the so-called "dual-purpose" expenditures, such as expenses on fuel and oil materials, car rent, etc.

[14] In accordance with an enterprise survey conducted by the International Finance Corporation in 2002, the corporate profit tax makes strategic planning and reporting more difficult, compared to other taxes.

The differences in positions of the executive government and the Verkhovna Rada on corporate profit tax reform is given in Table 2.

In our opinion, the draft by MPs will have a more encouraging effect on the business environment compared to that of the executive government. We ground our assumptions upon the following flaws of the cabinet draft:

- Significantly limited possibilities for the transfer of losses compared to the extant rules, as proposed by the government executive, would deteriorate the investment climate. Transferring the losses to future periods allows (1) to ensure the neutrality of the tax system in terms of business risks (investment, political, etc.), and (2) to automatically mitigate the tax burden during cyclic downfalls of the economy;
- The decision to apply ordinary prices to all enterprise operations, proposed by the executive government, would lead

Table 2. Divergence of opinion on corporate profit tax reform

Issue	Position of parliamentary deputies	Position of the executive government
Tax rate	Reduce to 25%	Keep it at 30%
Transfer losses to future periods	Eliminate limitations on the amount and terms of transferring losses to future periods	Limit the terms of loss transfer (5 years) and amounts of reductions (not more than 30% of non-taxable income for the corresponding year)
Deduction of expenditures	Allow adding 50% of expenditures on fuel/lubricants and car rental to gross expenditures	Gross expenditures for tax purposes cannot exceed by more than 10% the expenditures calculated on the basis of ordinary prices[15]
Depreciation	4 groups of capital assets. Computer equipment is allocated under a separate group (deduction norm is 15%). Depreciation norms increased by 60%	6 groups of capital assets. Separate groups include transmission devices and guided equipment[16] (deduction norm is 8%), vehicles (20%), and information systems (40%)
Administration	Abolishment of monthly advance payments. Tax to be paid quarterly, on the basis of actual results of enterprise activity, cumulatively from the beginning of the year	Monthly advance payments, to be calculated once a year on the basis of results of the previous year. Taxpayers will have the opportunity of adjusting calculated advance payments to the results of current economic activity

Source: International Centre for Policy Studies.

[15] Under extant legislation, "ordinary price is the sale price for goods (works, services) of the seller, including the sum of accrued (paid) interest, and the cost of foreign currency that can be obtained if it is sold to individuals not related to the seller under ordinary terms of economic activity". See the Law of Ukraine dated 22 May 1997 "On the corporate profit tax".

[16] That is, buildings and constructions of the main pipeline transport, buildings and constructions of communications and transmission lines, devices of electricity supply/distribution, vessels, railway locomotives and carriages, aerial and spacecrafts.

to unjustified interference in the activities of economic entities. Firstly, even the most exhaustive definition of ordinary prices would not cover all aspects of enterprise activity and price policy. Secondly, the large-scale practice of ordinary prices would not be an effective way of preventing tax evasion, due to the overly high expenditures that would be require to monitor prices and check all enterprise transactions;

- In accordance with the procedure proposed by the executive government, monthly advance payments would, in fact, be simpler than the current procedure. However, it contains significant drawbacks compared to the quarterly tax payments: (1) the procedure disregards the seasonal aspect of business activity, and (2) its usage would inevitably increase the tax pressure upon enterprises during cyclical downturns of business activity.

Ultimately, parties have found middle ground: on 24 December the Verkhovna Rada adopted the Law "On amending the Law of Ukraine 'On the corporate profit tax'", which envisages to implement the key MPs' proposals and measures, which will prevent State Budget revenues from shrinking dramatically over 2003. In general, changes envisaged in the law will positively affect business activity. These changes are as follows:

- The tax rate reduction by 5 percentage points to 25%, which will take place in 2004;
- 4 more groups of capital assets and 60% increase in depreciation norms. Simultaneously, changes pertaining to the 2nd and 3rd groups of capital assets will come into effect in early 2004;
- Elimination of limitations on loss transfer, accumulated from the enactment of this law, to future periods. Losses piled up hitherto will be deducted from the non-taxed profit only over three years from their accumulation;
- Abolishment of monthly advance payments and adoption of quarterly tax payments. In order to stabilise budget revenues over the next year, enterprises should make advance tax payments for January and also for eleven months.

Personal income tax

Personal income tax in Ukraine is expected to undergo the most radical changes in the course of tax reform. We see the following problems in the extant tax system:

- The high rate of personal income tax and payments to obligatory general social insurance funds drive up the cost of labour for business, with enterprises in labour-intensive sectors suffering the most from the high rate, primarily those with a high share of expenses on skilled employees;
- Tight tax pressure reduces savings possibilities, and thus stifles the development of small- and medium-sized businesses, for which access to lending markets is limited compared to big enterprises;
- The current system of tax administration imposes unproductive expenditures on both taxpayers and the State Tax Administration (STA).

On 21 November 2002, the Verkhovna Rada adopted in first reading the draft Law of Ukraine "On the personal income tax" tabled by the MPs. We believe that if adopted, this law would encourage economic growth, thanks to a sizable decrease in the tax burden upon both taxpayers and employers. The draft law envisages implementing the following changes:

- A dramatic cut in tax rates, particularly for the middle class,[17] and a decrease in the cost of labour, thanks to a reduced payroll tax;[18]
- A decrease of gross revenues for certain expenditures—specifically, expenditures on education, medical services, mortgage interest, non-state pension insurance, and leased immovable property maintenance.[19] The proposed system will allow to drive the tax burden down even further, as well as encourage citizens to invest in education, healthcare, and immovable property. This decision is more convenient for high-income individuals, who have more investment possibilities;
- Expansion of the tax base by taxing interest on deposits (at 5%) and proceeds from the sale of immovable property (net of documented expenditures for its purchase). These changes will above all ensure taxpayers' equality, where incomes are liable to taxation regardless of their source. At the same, the taxation of nominal deposit interest will actually be the same as taxing part of the main deposit sum. In order to avoid double taxation of incomes, it is necessary

Mandatory state insurance

Over October 2001–November 2002, the tax burden pressed more heavily upon enterprises, because more levies to state insurance funds were imposed. Pursuant to a Cabinet of Ministers of Ukraine resolution dated 11 April 2002, the maximum amount of payments to employees, from whom enterprises are obliged to deduct levies to mandatory insurance funds, increased from 1,600 to 2,200 hryvnias. This resolution testifies to the instability of tax policy and contradicts the norm of the Law of Ukraine "On the taxation system", which stipulates that changes in tax and levy collecting mechanisms are permitted only at the level of laws.

Furthermore, during this year the Verkhovna Rada adopted normative documents in first reading that dramatically changed the state insurance system:

- *draft Law of Ukraine "On mandatory state pension insurance";*
- *draft Law of Ukraine "On mandatory state medical insurance".*

Both draft laws envisage that the amounts of insurance payments are to be set annually by the Verkhovna Rada, based on the financial needs of corresponding bodies in charge of money allocation. We believe that given Ukraine's non-reformed pension and healthcare systems, such a decision will: (1) unjustifiably increase the instability of the tax system, thus having utterly unfavourable implications for investment; and (2) not create any incentives for effective spending by the corresponding funds.

We believe that the state insurance system demands reforms, above all in order to achieve stability in the amounts of levies and to reduce the administrative expenditures of enterprises. One option for eliminating flaws in the extant system can be to introduce a single social tax.

[17] According to research carried out by ICPS experts on the basis of the data from monthly surveys conducted by the GfK-USM company over 2000–2002, one of the features putting respondents in Ukraine's middle class is a monthly income exceeding 451 UAH. For more details on ICPS' research on the middle class, see **Quarterly Predictions**, No. 21 (October 2002), p. 56–57. Currently, citizens earning 451 UAH pay 17% of their income as personal income tax, while a new tax scale would allow paying only 10%.

[18] Under the draft law, the base for insurance deductions envisaged in the legislation on the obligatory state social insurance, cannot exceed 1,200 UAH. In line with the extant legislation, the base for deducting insurance payments cannot exceed 2,200 UAH.

[19] The amount of these expenditures cannot exceed the annual income declared by taxpayers; and maintenance expenditures on leased immovable property should not exceed 25% of the income from this type of activity.

to adjust interest incomes on deposits to inflation. In the same manner, taxing immovable property proceeds should also be adjusted to inflation levels.

Value-added tax

Over recent years, this tax provoked the most critisism, from both business representatives and the government. We see the following as being the biggest problems related to this tax:

- Debts on VAT reimbursements keep on accumulating, induced by: (1) weak mechanisms for controlling and preventing abuse by both taxpayers and the STA; and (2) vague legislation. The problem is that the existing definition of export operations leaves room for ambiguous interpretation; in particular, it gives grounds not to regard deliveries under CIF, FOB, etc. as exports. Under such circumstances, the competitiveness of Ukrainian exports weakens, and business risks shoot up;[20]
- Significant narrowing of the tax base since the tax was introduced, in the wake of more benefits extended. In particular, this applies to the privileged tax regime in agriculture and the annual rise in the number of benefits in special economic zones (SEZ) and priority development territories (PDT);[21]

Over the past year, government activities were more like "fire-fighting" than focussed on resolving long-term problems. Here, we see the following problems:

- In the wake of a drawn-out conflict with business representatives, the STA recognised deliveries under CIF, FOB, etc. as exports.[22] However, the Law of Ukraine dated 3 April 1997 "On the value-added tax" underwent no changes to try and eliminate any possibility of ambiguous interpretation of the "export transaction" definition, depending on what party transports goods across the border (buyer, seller, or an unrelated third party). This creates prerequisites for future conflicts;
- The government made no decisions in terms of paying out accumulated VAT refund debts. Meanwhile, the government wrote off the debts of enterprises that were entitled to tax debt write-offs in 2001,[23] and effected mutual write-offs with enterprises that received state-secured credits and budget loans.[24] The fact that undecided issues remain creates prerequisites for further use of mutual

[20] According to the results of a business opinion poll conducted by the International Finance Corporation in 2002, all managers, regardless of enterprise size or status, unanimously agreed that the extant system of VAT accruals and payments, along with the refund system, poses the biggest problem for their businesses.

[21] That is, the expansion of SEZ and PDT territories, a wider list of types of activity, and relaxed requirements as to investment volumes which should be injected in order to receive the benefits. For example the Law of Ukraine dated 7 February 2002 "On amending certain laws of Ukraine regarding the creation and functioning of special (free) economic zones and the implementation of special regimes of investment activity in priority development territories".

[22] See the order of the State Tax Administration of Ukraine dated 5 September 2002 "On approving the tax explanation regarding the procedure for applying a zero-rate value-added tax to goods exported across the customs border of Ukraine".

[23] See the Cabinet of Ministers of Ukraine resolution dated 1 March 2002 "On writing off state budget debts on VAT reimbursements accumulated since 1 January 2001".

[24] See the Cabinet of Ministers of Ukraine resolution dated 26 September 2001 "On putting in order VAT reimbursements and budget settlements".

write-offs and barriers to budget liquidity;

- In January 2001, the government abolished the right of joint enterprises, as well as enterprises to which all tax refunds have been paid, to use tax bills in order to increase budget revenues. Such a decision does not expand the tax base, and it raises additional barriers for certain import enterprises.

Meanwhile, important legislative decisions that would have allowed the prevention of rent-seeking and expanded the tax base have not been adopted.[25] This draft law comprises the following decisions, which would allow to prevent rent-seeking and enlarge the list of taxable operations, in particular:

- Canceling subsidies to agricultural producers and to enterprises of the meat- and milk-processing sector. Reforming the benefit tax regime in agriculture would mean that big enterprises (those which are legislatively required to register as taxpayers) pay tax on general terms. Small-sized enterprises in this sector would be entitled to accrue, deduct, and leave at their disposal VAT sums at 6% for forestry and fishery and 9% for other types of agricultural activity. We see this measure as being positive, since it would restore equal market conditions and foster competition thereby reducing possibilities for tax evasion. Of course, the price of abolished subsidies would lower profits of agricultural enterprises.
- Reforming the special economic zones. In our opinion, it is advisable to reduce the number of SEZ and PDT, and then divide them into narrowly specialised ones. In the process of SEZ liquidation it would be prohibited to approve new investment projects; meanwhile, projects that had already been initiated would be concluded in order to maintain confidence in the government;[26]
- Implementation of a separate tax regime for newly created enterprises, where they would be temporarily registered as taxpayers and entitled to tax credits only when their tax obligations arise and solely within their scope. The decision to limit refunds for newly created enterprises is fully justified, since most frequently evasion from proper VAT payments is done through creating fake firms. Concurrently, such regulation will raise more barriers to market entry and will cause a higher inflow of applications for the creation of new enterprises in free economic zones.

Other changes: equality of taxpayers

This year, the Verkhovna Rada abolished excise benefits for ethanol and wine produced by domestic enterprises,[27] which will ensure equal conditions in the market.

At the same time, the following legislative decisions are expected to exacerbate the inequality of tax burden distribution:

- Granting benefits in the taxation of proceeds from equipment sales for export. Apart from creating unequal conditions in the machine-building sector, such benefits (which are actually export subsidies) contradict WTO rules, and

[25] See the draft Law of Ukraine dated 29 June 2002 "On amending the Law of Ukraine 'On the value-added tax'".

[26] See **Quarterly Predictions**, No. 20 (July 2002), p. 41–42.

[27] See the Law of Ukraine dated 24 October 2002 "On amending certain laws of Ukraine pertaining to taxation, production, and turnover of excisable goods".

hence can prompt countermeasures by Ukraine's trading partners;[28]

- Granting tax benefits to enterprises[29] generating more than 70% of their proceeds from the sale of innovative products received over the accounting period;[30]
- Tax benefits extended to enterprises manufacturing trucks and autobuses[31] (see **OPEN ECONOMY**).

[28] See the Law of Ukraine dated 7 February 2002 "On stimulating domestic machine building for the agri-industrial complex".

[29] See the Law of Ukraine dated 4 July 2002 "On investment activity".

[30] Products are seen as innovative if they fall under the following requirements: (1) produced by a registered innovative project on the territory of Ukraine; (2) produced on the territory of Ukraine; (3) were produced for the first time in Ukraine, or if not for the first time, then compared with other analogous products displayed in the market, such products must be more competitive and have a substantially higher technical and economic indicators; and (4) its products were recognised as innovative by the state agency for innovative activity.

[31] See the Law of Ukraine dated 15 November 2001 "On amending certain legislative acts of Ukraine on the state support for the car-manufacturing industry".

Regulation of economic activity

Over October 2001–November 2002, no notable changes occurred in government policy regulating economic activity, with support for small business remaining only declarative. Moreover, there was a movement away from the single licensing procedure during this period, which pushed up enterprises' administrative expenditures. As to positive changes in the legislation regulating business activity, among the key ones were the demonopolisation of the market providing confirmation of compliance services, and the adjustment of the Law of Ukraine "On the quality and safety of foodstuffs and food raw materials" to the norms of the World Trade Organisation

Small business policy

In order to enforce the Law of Ukraine dated 21 December 2000 "On the national program to promote small business development in Ukraine", on 16 November 2002 the Cabinet of Ministers of Ukraine issued the Directive "On measures to enforce the National Program to Promote Small Business Development in 2003". The list of program tasks includes the following: (1) develop legislative acts aimed at simplifying conditions for the activities of small enterprises, and (2) determine undertakings which will require targeted financing, including the creation of new databases, implementation of educational programs, and scientific research works on regulatory policy. However, this document fails to specify sources of financing, stating only that it should be included in the State Budget for 2003. Furthermore, no mechanism is created for allocating funds for the different measures; in our opinion, under such conditions it is most unlikely that they will be implemented.

Licensing of business activity

Over October 2001–November 2002, there was movement away from the single procedure for licensing business activity, and the number of licensable types of activity increased. We believe that the failure to enforce the transparent single procedure will lead to increased administrative expenditures of enterprises, and corruption in corresponding government bodies. In particular, the procedure was violated with regard to the following types of activity:

- **Higher education.** The Law of Ukraine dated 17 January 2002 "On higher education" establishes a special procedure for licensing in the sphere of education, with the term "licensing" in this law differing substantially from the formulation used in the Law of Ukraine "On licensing certain types of economic activity". The requirement of conducting preliminary licensing expertises is none other than a rejection of the application principle;
- **Perfumery and cosmetics production.** The Law of Ukraine dated 7 March 2002 "On amending Article 9 of the Law of Ukraine 'On licensing certain types of economic activity'" instituted the licensing of perfumery and cosmetics production utilising ethanol. In our opinion, such production is not hazardous to hu-

man life or health, to the environment, or to state security, therefore there is no need for any special permission. We believe that the state ushered in licensing for this type of activity solely to tackle the problem of tax evasion. However, this is improper, since it heaps unjustified expenses upon law-abiding enterprises.

Compact discs (CDs)

The need to enhance the protection of intellectual property rights (IPR) prompted the introduction of licensing for compact discs[32] (see **Open Economy**). Our assessment of this fact is positive, all the more so that the licensing procedure for the two types of activity (the production of compact discs and the export/import of equipment/CDs) follows the single procedure for licensing business activity.

Nonetheless, we believe that the law has drawbacks, due to the fact that the amendments entered into the Law of Ukraine "On licensing certain types of economic activity" apply to all types of activity in Ukraine necessitating licenses. Firstly, the data listed in licenses was additionally extended with the item "Appendix (indicate number of pages)". The Law of Ukraine "On the particularities of state regulation of the activities of economic entities related to the production, export, and import of compact discs" reveals the content of this document (data on production equipment and storage facilities), but this requirement now applies to other types of activity. This will create opportunities for corruption, since licensing agencies may require all kinds of appendices. Secondly, the notion of "monitoring the existence of licenses" is introduced, which will imply corresponding on-site checks at enterprises.

Economic competition

In order to enforce the Law of Ukraine dated 11 January 2001 "On the protection of economic competition", during the evaluated period two normative acts were adopted. Firstly, a Directive of the Antimonopoly Committee dated 25 December 2001 "On the Regulations on the procedure for conducting checks of compliance with legislation on the protection of economic competition". The document establishes: (1) clear procedures for conducting scheduled and unscheduled checks; (2) an inclusive list of reasons for conducting unscheduled checks; and (3) the main principles used in forming lists of economic entities subject to scheduled checks (in particular, small and medium-sized enterprises are not included on the list). We believe that this directive will improve the transparency of relations between enterprises and the Antimonopoly Committee.

Secondly, on 28 February 2002 the Cabinet of Ministers of Ukraine issued a Resolution "On approving the Procedure for issuing the Cabinet of Ministers of Ukraine permission to engage in coordinated activities, and the concentration of economic entities", which establishes the procedure to provide it, as well as the authorities and ways of interaction between the Ministry of Economy and the Antimonopoly Committee. This gives grounds to hope that the introduction of the new procedure will enhance the protection of competition in Ukraine.

Technical regulation

Over the report period, the status of the authorised body on technical regulation underwent crucial changes: the State Committee on Standardisation, Metrology, and Certification of Ukraine was transformed into the State Committee of Ukraine on Tech-

[32] See the Law of Ukraine dated 17 January 2002 "On the peculiarities of state regulation of activities of economic entities that are related to the production, export, and import of compact discs".

nical Regulation and Consumer Policy[33]—a central executive government body with special status. We believe that it will take on the majority of managerial functions in this sphere, despite the declared separation of powers that should delegate them to corresponding sectoral government bodies.

A positive accomplishment in the government policy on technical regulation was the adoption of a Cabinet of Ministers of Ukraine resolution dated 28 March 2002 "On approving the procedures for certification agencies to grant authorities for providing services confirming compliance in legislatively regulated spheres", which will spur the demonopolisation of this sector. The resolution creates an independent agency for accrediting enterprises that provide services of confirming compliance. Thus, now even private enterprises will be able to provide such services, whereas before, solely enterprises of the UkrSEPRO Ukrainian State Product Certification System were entitled to confirm compliance.

An essential sequel to the abovementioned resolution was the Cabinet of Ministers of Ukraine resolution dated 11 April 2002 "On approving the Rules for calculating the cost of works confirming compliance in legislatively regulated spheres", which determines the inclusive list of payable services, as well as labour content standards for works confirming compliance; these rules will allow the prevention of any unjustified price surges on such services.

Holographic protection

The mandatory usage of holographic protective elements for documents and goods was actually implemented after the adoption of the Cabinet of Ministers resolution dated 5 July 2002 "On approving the lists of documents and groups of goods subject to protection with holographic elements". This list includes: (1) personal medical record books (form No. 1-OMK); (2) medical certificates confirming the ability to drive vehicles (form No. 083/o); (3) permits to launch the work of enterprises, institutions, and organisations; (4) excise marks on alcohol products; (5) excise marks on tobacco products; (6) blank certificates of compliance of the UkrSEPRO state certification system, along with appendices and copies; and (7) blank certificates of acknowledgement, along with appendices and copies.

Our arguments against the mandatory usage of holographic protection are as follows:

- the holographic protective element in medical books or certificates does not guarantee the authenticity of the record, nor of observance of established procedures;
- holographic protection of excise labels, certificate forms, and certificates of acknowledgement increase the operational and administrative costs of business entities, while the implications of its usage do not differ from those induced by the system of "rigid accountability forms".

We believe that the only enterprises benefiting from such an innovation would be the ones producing holographic protective elements. In our opinion, this procedure should be voluntary so that non-productive expenditures can be avoided.

Food product quality and safety

On 24 October 2002, the Verkhovna Rada adopted the Law of Ukraine "On amending the Law of Ukraine 'On the quality and safety of foodstuffs and food raw materials'", aiming to enhance consumer safety, adjust the law in question to WTO norms, and align it with EU laws. In our opinion, it includes the following positive features:

[33] Pursuant to the Presidential Decree dated 1 October 2002 "On the State Committee of Ukraine on Technical Regulation and Consumer Policy".

- New necessary terms were introduced (e.g., "forged products", "poor-quality products", "unsafe products") and those already existing were made more precise (e.g., "biologically active food supplements");
- Certification was taken out of the purview of the law, since it is regulated by the Law of Ukraine dated 17 May 2001 "On confirming compliance";
- The concept of "public catering service" was abolished (instead, only the concept of "food products" is used), which will eliminate the need for double-checking food quality indicators and sanitary norms in public catering facilities;
- The State Registry for Special and New Food Products was introduced, replacing the state registry for all foodstuffs and raw food materials, which were virtually impossible to cover;[34]
- New requirements for marking food products were introduced, which must include information about nutrition and energy value, date of manufacture or expiry and "best before" date, existence of genetically modified materials, and consumption warnings for certain groups of people—as required by the European Union.

At the same time, the law extends the list of documents required to confirm compliance. Now, the list includes a certificate of hygiene; additionally, depending on the territory where enterprises aim to sell products of animal origin, different veterinary documents will be required.

Our opinion is that although the law will drive up enterprise expenditures for adjusting to the new rules in the short run, the total effect from its adoption will be positive, since it harmonises measures regarding food quality and safety with EU legislation and enhances the protection of food consumers.

Impact of land legislation on the regulation of business activity

The Land Code of Ukraine, passed by the Verkhovna Rada on 25 October 2001 (see **Agriculture**), restrained the rights of perpetual land usage by private enterprises (this right was only retained by enterprises which manage multi-unit housing blocks).

According to the Transitional Provisions of the Land Code, enterprises that lost their right of perpetual land usage should re-register their rights of usage as rights of ownership or rental by 1 January 2005. Whereas it is very costly to buy out land plots, in our opinion the majority of small and medium businesses will shift to land rental. However, this will worsen the business climate, because land rent fees will be paid in addition to the single tax—unlike the land tax established for landowners and users. Besides, there are risks that local government bodies will seek to conclude short-term land lease agreements in order to create possibilities for obtaining kickbacks.

[34] Under the Law of Ukraine dated 24 October 2002 "On amending the Law of Ukraine 'On the quality and safety of food products and raw food materials'", "special food products" include dietetic, health-promoting, and preventive food products and biologically active food supplements, baby food, and food for athletes; and "new food products" are either those (1) produced for the first time in Ukraine; (2) using components not used before or genetically modified ones; (3) imported for the first time to Ukraine; or (4) produced based on new technologies which significantly alter their physical and chemical indicators and/or their nutritional value.

Open economy

Over October 2001–November 2002, the Verkhovna Rada and the Cabinet of Ministers of Ukraine did little to adjust legislation to WTO norms. The adoption of a new Customs Code and a Law of Ukraine "On the particularities of state regulation of business entities, associated with production, export, import of CDs for laser data-reading systems" were the only accomplishments in this area. Moreover, protectionism increased, manifesting in the adoption of laws which contradict WTO requirements. In our opinion, this situation is due to (1) the disinterest of powerful interest groups in acceding to this organisation; and (2) the lack of a mechanism for monitoring the compliance of draft laws and government resolutions with WTO norms. A constructive move fostering market openness to labour migration became the abolishment of limitations on the employment term for foreigners and stateless individuals in Ukraine

Trade openness

The World Trade Organisation (WTO) furnishes the institutional framework and coordination for the liberalisation of international trade. Accession to this organisation, for which Ukraine has been preparing for nine years already, requires the adjustment of national legislation to WTO norms. The most important changes to be made by the Verkhovna Rada and the Cabinet of Ministers in Ukrainian laws and normative acts in order to bring them into line with WTO norms are stipulated in a decree of the President of Ukraine as follows:[35]

- to enforce national treatment in the economy[36] (to date, this has not been done in the sectors of financial, banking, telecommunications, transport, medical, and insurance services, nor in the electricity or automobile manufacturing sectors[37]);
- to eliminate discriminatory protectionism in agriculture (import and export quotas and subsidies, which are banned by the WTO Agriculture Agreement), in the ferrous metallurgy complex (export duty on ferrous scrap metal, prohibition of non-ferrous scrap metal exports), and automobile manufacturing (conducting discriminatory special investigation);
- to modify technical regulations (standardisation, certification, sanitary and phytosanitary norms) in accordance with international standards;
- to improve the protection of intellectual property rights (IPR).

[35] See the Presidential Decree dated 5 February 2002 "On the action program for the final stage of Ukraine's accession to the World Trade Organisation".

[36] The national treatment is intended to ensure equal footing for national and foreign enterprises, operating in Ukraine or selling their products here. The national treatment is breached if, for instance, tax benefits are extended to national enterprises competing with importers of analogous products.

[37] See **Quarterly Predictions**, No. 19 (April 2002), p. 34–35.

Unfortunately, over the past twelve months the Verkhovna Rada and the Cabinet of Ministers have hardly done anything in terms of adjusting Ukrainian legislation to WTO norms (the only major changes were adopting a new Customs Code and a law regulating the production, export, and import of CDs). Moreover, protectionism increased, manifested in the adoption of laws contradicting WTO requirements. We believe this situation is due to (1) the disinterest of powerful interest groups in acceding to this organisation; and (2) the lack of a mechanism for monitoring the compliance of draft laws and government decisions with WTO norms.

Customs Code

The Verkhovna Rada adopted a new Customs Code[38] after debating it for almost four years. The new Customs Code was designed in line with international standards in the domain of goods classification and coding, customs procedures (customs control and clearance, customs value assessment, identification of country of origin, etc.). The simpler and more transparent customs procedures stipulated in the newly adopted Customs Code will allow the reduction of transaction expenditures for foreign trade agents.[39]

The key positive changes compared to the previous code are the following:

- Recognition of the equality of customs procedures, regardless of country or owner of goods/vehicles, and establishment of legislative regulation for customs regimes[40] and conditions of their application to export/import transactions;
- Switch to new methods for assessing the customs value of goods. Now, the Customs Code makes an allowance for the possibility that prices set by different importers may vary for the same product. The customs agencies may disregard the contract cost when setting the import duty only when the veracity of the declared price is doubted. Even in such cases, the customs agencies must permit importers to justify their price, and must present a written explanation for their refusal to use the contract cost if the justification fails to satisfy them;
- Introduction of new rules for identifying country of origin, based upon WTO principles. These rules neither restrict nor distort external trade, since they do not require the fulfillment of requirements irrelevant to production or processing;
- The possibility to apply simpler customs clearance procedures to foreign trade agents who over a certain period of time have not violated cross-border shipment terms. In addition, it is now possible to use a simpler declaration form for occasionally imported goods (a periodical customs declaration).

The final version of the code takes into consideration the remarks of the President expressed when vetoing the Customs Code adopted by the Verkhovna Rada of Ukraine on 20 December 2001: (1) the parts pertain-

[38] The Verkhovna Rada adopted a new Customs Code on 11 July 2002, which will come in effect on 1 January 2004.

[39] According to the results of the enterprise survey held by the International Finance Corporation in 2002, 46% of respondents consider customs procedures to be a grave obstacle to the development of their enterprises. Specifically, respondents believe that customs procedures are overly expensive, time-consuming, and cumbersome.

[40] The customs regime is a set of legal provisions, established by the customs legislation, which set the border-crossing order in Ukraine for vehicles and goods and the application of customs procedures to them depending on border-crossing purpose. All in all, there are 13 customs regimes established, specifically, import, re-import, export, re-export, goods transit, temporary goods import (export), customs licensed warehouses, processing on the territory of Ukraine. The extant Customs Code is lacking the notion of the customs regime.

ing to tax and levy collection, as well as to the functioning of special economic zones, were deleted, since they are regulated by other laws; and (2) the State Customs Service (SCS) was deprived of the right to engage in operative and investigative activity (the previous version of the code had equaled the SCS to law-enforcement agencies in status).

In order to efficiently implement the new Customs Code, it is essential to coordinate all relevant by-laws with it, specifically, with the Cabinet of Ministers Resolution dated 5 October 1998 "On approval of the Procedure for Assessing the Customs Value of Goods and Other Items When they Cross the Customs Border of Ukraine".

Intellectual property rights protection

The adoption of the Law of Ukraine "On particularities of state regulation of business entities, associated with production, export, import of CDs for laser data-reading systems" can significantly enhance the protection of intellectual property rights (IPR) in Ukraine, without overly hampering manufacturers' activity, since:

- The law only applies to recorded audio and video discs (the previous draft law,[41] which had been adopted in first reading, introduced obligatory licensing and tight control over all CD production);
- Pursuant to this law, responsibility for violating IPR will be laid on customers, with fines in the amount of 200% of the cost of the goods, but no less than 3,000–5,000 non-taxable minimum amounts; if the offense is committed in "large amounts", the law envisages detainment for up to five years. We believe that this punishment is severe enough to significantly outweigh the expected gain from pirate activity;
- The law will limit the possibilities for excessive inspections.[42]

However, in the past twelve months the Civil Code, which should provide for framework regulation of intellectual property rights has not been approved (see **Property relations**). Moreover, despite the dramatic improvement of legislative regulation of IPR, the volume of infringed rights has hardly diminished, and unlicensed audio and video discs are sold with virtually no limitations. In our opinion, the reasons behind this situation remain: (1) the disinterest of most of society in IPR protection; and (2) the absence of effective mechanisms for enforcing corresponding legislative acts.[43]

Protectionism

Automobile manufacturing

Over the past year, measures were undertaken to protect the national automobile industry. Firstly, the Verkhovna Rada adopted a law[44] which (1) extends tax benefits (exemption from VAT and import duty, benefits on the corporate profit tax, the tax on dividends, and the land tax) to manufacturers of autobuses and trucks, as well as manufacturers of spare parts for them (as long as investments in the share capital of these

[41] Evaluation of the draft law, which has not been adopted in second reading due to blatant flaws, see **Quarterly Predictions**, No. 17 (October 2001), p. 40.

[42] When conducting a regular check of observance of license terms and conditions, state controlling agencies should notify a manufacturer ten days in advance. In addition, controlling agencies have the right to spot-check upon written inquiry/statement, although a person demanding this spot-check will be liable if the facts supplied by him/her will not be confirmed.

[43] For more details, please see **Policy Studies**, No. 16 (October 2001), p. 28.

[44] See the Law of Ukraine dated 15 November 2001 "On amending certain legislative acts of Ukraine on state support for Ukraine's car-manufacturing industry."

enterprises amounts to not less than 30 million and 10 million USD, respectively);[45] and (2) drives up import duty rates for spare parts of automobiles up from two- to ten-fold for enterprises not enjoying these tax benefits.

In our opinion, increasing tax benefits strengthens the discriminatory protection of certain enterprises in this sector. The higher import duty on spare parts will bring net losses for the manufacturing industry, with both assembly plants and consumers suffering from significantly higher repair costs; in the meantime, the government increased its support to inefficient production—primarily of the AvtoZAZ-Daewoo Company, which crippled by competition from other auto manufacturers.

Secondly, a special 32% import duty was imposed upon Russian cars, in force till 8 December 2002.[46] The basis for introducing the special import duty on Russian cars was the result of a special probe into the damages incurred by AvtoZAZ-Daewoo and the Lutsk Automobile Plant from the imports of Russian cars. We consider this conclusion to be doubtful, given the large number of benefits received by these enterprises (especially AvtoZAZ-Daewoo). It is rather proof of the uncompetitiveness of these Ukrainian products. Furthermore, we believe that the 32% import duty on Russian automobiles will lead to net losses for Ukraine's economy, due to the following reasons:

- support being extended in Ukraine for the inefficient production of automobiles that are of lower quality and have a higher price than they would under competitive conditions, and thus they are uncompetitive in the global market;
- consumers suffer because they cannot afford to purchase the items they want—to illustrate, following the introduction of the import duty, the price of AvtoVAZ cars grew by 400–1,500 USD, which is critical for cars of this category.

Ferrous metallurgy

Here, protectionism manifested itself in the introduction of a 30 euro per ton export duty on waste ferroproducts and ferrous scrap metal.[47] In our opinion, this move will cause the following adverse repercussions: (1) the introduction of an export duty is, in other words, a subsidy for metallurgic enterprises, which will permit Ukraine's trading partners to resort to countervailing measures; and (2) such practice is a breach of WTO norms and will be one more hurdle in Ukraine's accession to this organisation.

Anti-dumping probes into Russian goods imports

Over the past twelve months, Ukraine conducted anti-dumping measures against electric lamps, artificial fur, and iron ore imported from Russia, and held special probes into the import of Russian soda, cement, and passenger automobiles.[48] In our opinion, Ukraine and Russia restrict their mutual trade due to pressure from certain national producers which lobby for protectionism. Restrictions on imports will lead to increased production of less competitive na-

[45] Pursuant to this law, before only those car-manufacturing enterprises had been granted benefits, the sum of investment in which totaled not less than 150 million USD. In fact, benefits reached only one enterprise—AvtoZAZ-Daewoo.

[46] On 10 December 2002 the Inter-Departmental Commission on International Trade adopted a decision to impose quotas for Russian car imports.

[47] See the Law of Ukraine dated 24 October 2002 "On exit (export) duty on waste ferroproducts and ferrous scrap metal".

[48] In 2002, Russia resorted to anti-dumping measures with regard to imports of Ukrainian pipes, caramel, steel rods, and flat-rolled metal and conducted special probes into imports of Ukrainian tyres and crystal silicon.

tional products, and inflate their price. Consequently, the economies of both countries sustain net losses, for their resources are inefficiently employed while consumers suffer as they are forced to buy lower-quality and higher-priced products.

Openness to labour migration

The lifting of restrictions on employment terms for foreigners and stateless individuals in Ukraine[49] (until now, the maximum employment term was four years) was a move forward in bringing down the barriers to labour migration. Employment permits will be issued for one year, with the possibility of extending them.

Nevertheless, we believe that excessive barriers to labour migration still persist in Ukraine. For instance, pursuant to the Cabinet of Ministers Resolution dated 1 November 1999 "On approving the Procedure for Issuing Employment Permits to Foreigners and Stateless Individuals in Ukraine" foreigners can obtain employment permits only if there are no workers in the country capable of performing the given type of work, or if there are sufficiently justified reasons for employing foreign experts. In general, ten different documents must be submitted to obtain this permit, and the whole procedure takes a month on average.

[49] See the Cabinet of Ministers Resolution dated 17 May 2002 "On modifying the procedures for issuing employment permits in Ukraine for foreigners and stateless individuals".

Financial sector

During October 2001–November 2002, key legislative changes in the financial sector aimed at regulating the activity of non-banking institutions and counteracting money laundering were introduced. Over this period, the Verkhovna Rada adopted the following key pieces of legislation: "On the prevention and counteraction of legalisation (laundering) of incomes acquired by criminal means", "On credit unions", and "On amending the Law of Ukraine "On insurance". However, during this time the government did not manage to devise a long-term development strategy for the Ukrainian financial sector

We believe that the following trends in Ukraine's financial sector have been persisting: (1) a relatively low level of financial mediation; and (2) an asymmetric development of the banking and non-banking sectors.[50] We see the following overriding problems which stifle the development of the Ukrainian financial system most of all as:

- the lack of a long-term development strategy for the sector;
- delays in creating a supervisory agency over non-banking financial institutions, and an insufficient number of normative acts regulating their activity;
- inconsistent protection of banks depositors;
- a lack of legislatively approved rules for electronic signatures;
- insufficiently active fight against money laundering.

The government's policy in Ukraine's financial sector over October 2001–November 2002 sought to regulate the activity of non-banking institutions and fight against money laundering. During this period, the Verkhovna Rada undertook certain moves in resolving the above problems, particularly in the adoption of a new version of the Law of Ukraine "On insurance", as well as laws "On credit unions" and "On the prevention and counteraction of legalisation (laundering) of incomes acquired by criminal means". However, during this time the government did not manage to design a long-term development strategy for the financial sector.

Regulation of non-banking financial institutions

As we had predicted earlier, the vagueness in the Law of Ukraine dated 12 July 2001 "On financial services and state regulation of financial services markets"[51] regarding the establishment terms for the State Commission on Financial Services Market Regulation (the authorised executive government body regulating financial services markets) delayed the process of its formation.[52] This situation,

[50] See **Policy Studies**, No. 16 (October 2001), p. 31.

[51] See **Policy Studies**, No. 16 (October 2001), p. 31.

[52] The State Commission on Financial Services Market Regulation was formed only on 11 December 2002. Practice has shown that the establishment and formation of a new executive authority in Ukraine lasts 6–12 months.

in turn, led to the following negative consequences:

- The activities of non-banking financial institutions in the banking transactions market were blocked, since according to the NBU's Regulations on the procedure for issuing licenses to engage in certain banking operations by non-banking institutions,[53] in order to provide financial services they have to obtain such a document from the authorised executive body in this sphere;
- The development of credit unions slowed; pursuant to the Law of Ukraine dated 20 December 2001 "On credit unions", they are to be registered by the State Commission on Financial Services Market Regulation. Furthermore, the activities of credit unions will be hampered by double reporting, since they have to agree their charters and financial issues with the National Bank of Ukraine. We believe that in order to curtail state regulation expenditures and credit unions' cost of business, control should be exercised by a single body.

Over the research period, only the activities of credit unions were regulated by law, in contrast to those of pawnbrokers and non-state pension funds.

Credit unions

We believe that the Law of Ukraine "On credit unions" contains the following positive features:

- The law makes it impossible to create "pocket" credit unions by stipulating that (1) the number of founders should be not less than 50 individuals; (2) credit union obligations towards any single member (specifically, liabilitity on deposits) cannot exceed 10% of the total obligations; and (3) the size of a loan granted to a single member cannot exceed 20% of the capital;
- Credit unions are allowed to create local cooperative banks, which are still non-existent in Ukraine. This will spur their development and will allow the use of a wide variety of financial tools;
- In order to mitigate bankruptcy risks for credit unions, the law sets clear requirements as to their capital,[54] which cannot be less than 10% of total obligations. Thus, the overly active involvement of money is obstructed; in particular, the total amount of borrowing should not exceed 50% of total obligations, or of the credit union's capital on the day of borrowing.

However, in order to effectively enforce the Law of Ukraine "On credit unions", numerous by-laws should be adopted.

Capitalisation requirements to financial institutions

Over the research period, capitalisation requirements to financial institutions were tightened:

- On 4 October 2001, the Verkhovna Rada adopted the Law of Ukraine "On amending the Law of Ukraine 'On insurance'", imposing tighter requirements for the size of the share capital of insurance companies. Within two years of the adoption of the law, it should be enlarged from 100,000 to 500,000 euro, and to 1 million euro within the third year; moreover, for life insurance companies the amounts are from 500,000 to 750,000 euro and to 1.5 million euro, respectively;
- The National Bank of Ukraine issued Regulations on the procedure for granting general licenses to non-banking financial institutions for engaging in hard currency transactions, which require

[53] The NBU adopted these Regulations on 16 August 2001, and they came into effect on 1 January 2002.

[54] Credit union capital consists of share, reserve, and additional capitals, as well as the remainder of its undivided revenues.

having share capital equivalent to not less than 0.5 million euro as a condition for granting this license.

We believe that trends in the insurance services market will be similar to those in the banking sector over 2001–2002:[55] (1) merging and buyouts of small companies; and (2) the sector will attract foreign capital. The inflows of foreign capital will be stimulated by the following provisions of the Law of Ukraine "On insurance": (1) eliminated restrictions as to the share of foreign participants in the share capital of insurance companies;[56] and (2) relaxed requirements as to the forming by insurance companies of charter funds of other insurance companies of Ukraine.[57] Concurrently, the norm stating that only residents can act as insurance companies in Ukraine will have an adverse effect; this increases foreign companies' expenditures on launching business in Ukraine.

Compensation of losses from bankruptcy incurred by financial institutions

During this research period, the Verkhovna Rada undertook the following measures, promoting the boost of public confidence in the banking system:

- Adopted the Law of Ukraine dated 7 March 2002 "On putting in order the debts owing on the individual deposits of depositors and other creditors of the Ukraina Joint-Stock Commercial Agro-Industrial Bank", altering the order of claims satisfaction. The law recognises first-priority creditors to be individuals whose bank contributions did not exceed 50,000 UAH, while second priority was given to persons whose requirements were secured by pledge (which traditionally has priority), and the National Bank of Ukraine and State Tax Administration were placed among the creditors of the third line;
- Approved the Law of Ukraine dated 20 September 2001 "On the Fund for Guaranteeing Individual Deposits", which raised the secured maximum of reimbursements to depositors from 500 UAH to 1,200 UAH.

Furthermore, the absence of new bankruptcies among Ukrainian banks over 2002, and a gradual rise in the number of members of the Fund for Guaranteeing Individual Deposits (FGID),[58] allowed the latter by YE'02 to increase the size of secured reimbursements to 1,500 UAH. We believe that this change resolved the problem of insuring the deposits of a large portion of society, given that at YE'02 deposits of up to 1,500 UAH at commercial banks accounted for more than 85% of the total.

We believe that the precedent of adopting a separate law on the bankruptcy of a specific company can become a misguided practice of unfair distribution of liquidation assets.

[55] The Law of Ukraine dated 7 December 2000 "On banks and banking activity" imposed more rigid requirements as to the minimal amount of the banks' share capital: 1 million euro for local cooperative banks; 3 million euro for commercial banks operating on the territory of a single oblast; and 5 million euro for banks operating on the whole territory of Ukraine. These requirements will come into effect on 17 January 2003.

[56] In the previous redaction of the law, the total share of foreign legal entities and foreign citizens in the shareholder capital of insurance companies could not exceed 49%.

[57] The maximum allowable total amount of contributions made by an insurance company to the share capital of other insurance companies in Ukraine picked up from 20 to 30%; in particular, the size of contributions to the share capital of an individual insurance company was raised from 5 to 10%.

[58] The fund numbers 150 member banks (out of 154 having an NBU license for banking operations). The Oschadbank Savings Bank is not a FGID member; individual deposits in this bank are guaranteed in full by the state.

In addition, the bankruptcy of the Sloviansky and Ukraina banks revealed that nowadays the following problems related to the protection of depositors' rights are foremost: (1) long waiting period for compensation of business losses; and (2) the high risk of non-reimbursements to creditors of second or lower priority. We believe that given a deficit in liquidation assets, compensation to depositors and investors should be proportionate to the size of their contributions, except for the founders and the regulatory agency, which should be the last to be reimbursed.

Regulation of the stock market

No notable changes in the legislation regulating stock market activity occurred in October 2001–November 2002. The outdated framework Law of Ukraine "On securities and the stock exchange", adopted in 1991, is still in effect, while the draft law "On securities and the stock market", which is to supersede it, has been fruitlessly debated by the Verkhovna Rada for three years already.

Additionally, over the research period the Verkhovna Rada entered no amendments to the Law of Ukraine dated 12 October 1997 "On the National Depository System and particulars regarding the electronic circulation of securities in Ukraine" that would improve the system of ownership rights accounting in Ukraine. In our opinion, this law needs to undergo the following modifications: (1) creation of a single Central Depository, which will eliminate the conflict between the state National Depository of Ukraine, and non-state Interregional Stock Union depository; and (2) strengthening the protection of registrars' and keepers' rights, which would allow decreasing the risks of their activity and reducing the costs of their services.

Progress was achieved only in regulating the activities of joint investment institutions, which given the immature stock market in Ukraine are the most suitable venture funds. Adoption of essential by-laws[59] permitted the granting of the first licenses to asset management companies at YE'02. We expect that already in 2003 there will emerge new joint investment institutions in Ukraine, which will work with the funds of legal entities.

We are of the opinion that the decision of the State Property Fund of Ukraine, the State Committee on Securities and the Stock Market (SCSSM), and the Antimonopoly Committee dated 31 January 2002 regarding restrictions on and gradual reduction of tariffs for the services of registrars (who are monopolists) to an economically justified level will not resolve the problem of "pocket" registrars. In fact, this decision would result in a reduced number of independent registrars, for whom keeping registries is their only activity, while enlarging the share of bank registrars, which can cross-subsidise these services. Instead, it would be expedient to boost the requirements of registrars' capital and limit the number of self-regulated organisations—one for each type of activity.

Legalisation of electronic signatures

On 12 September 2002, the Verkhovna Rada adopted the first reading of the Law of Ukraine "On electronic digital signatures", which equals them in legal validity to handwritten signatures. We regard it as expedient to adopt this law as soon as possible, since it will allow to: (1) cut the costs of financial transactions; (2) speed up settlements; and (3) create the legal framework for electronic document circulation.

[59] The framework Law of Ukraine "On joint investment institutions (share and corporate investment funds)" was passed on 15 March 2001. For more details on this law, see **Policy Studies**, No. 16 (October 2001), p. 35–36.

Combating money laundering

The fact that Ukraine was added to the FATF[60] blacklist in autumn 2001, along with the greater threat of sanctions being imposed by this international organisation, hit the country's financial sector most heavily; its agents began receiving additional inquiries from their overseas partners, who demand higher prices for their services. The FATF has insisted that Ukraine ratify a law on illegal money laundering and regulate the activities of its authorised financial monitoring agency.

On 28 November 2002, the Verkhovna Rada adopted the Law of Ukraine "On the prevention and counteraction of legalisation (laundering) of incomes acquired by criminal means", tightening control over financial transactions with the following measures:

- Legally approving the creation of a State Department for Financial Monitoring as the official government financial monitoring agency;[61]
- Two levels of financial monitoring were established—primary (banks, financial institutions, and other legal entities engaging in financial transactions) and state (NBU, the State Committee on Securities and the Stock Market (SCSSM), as well as the specially authorised financial monitoring body);
- It is permitted to consider any transaction which seems dubious to a primary monitoring agency to be a money laundering one;
- The Code of Ukraine on Administrative Offences was amended, namely: a penalty was introduced for disclosing information pertaining to financial transactions subject to monitoring. It amounts to 100–300 non-taxable minimum monthly individual incomes (1,700–5,100 UAH). We believe that this move will not make monitoring bodies more responsible, because the penalty is too small compared to the value of trade secrets.

Additionally, the National Bank of Ukraine tightened its grip over foreign branches of Ukrainian banks. Firstly, the NBU regulated the procedures for granting permission to make overseas investments in creating subsidiary banks, affiliates, and bank representative offices on the territory of other states; only banks with share capital of at least 10 million euro can create subsidiary banks or affiliates, and in order to open a representative office, a bank's share capital must be no less than 5 million euro.[62] In our opinion, strict regulation of the opening of overseas bank branches will help the NBU to control them better.

Secondly, the NBU introduced a mandatory review of banks' foreign branches when their head offices undergo a comprehensive review.[63] However, there are to be no reviews if

[60] FATF (Financial Action Task Force on Money Laundering) is an inter-governmental body which devised the "Forty Recommendations on Measures to Combat Money Laundering" and "Special Recommendations on Terrorist Financing". FATF members include 29 countries and two international organisations.

[61] The State Department for Financial Monitoring was created in January 2002 pursuant to a Cabinet of Ministers of Ukraine resolution.

[62] See the resolution of the NBU Board dated 30 January 2002 "On the approval of the Regulations on the procedures for opening subsidiary banks, affiliates, or representative offices of Ukrainian banks on the territory of other states, and particulars concerning their closing and supervision thereof".

[63] See the resolution of the NBU Board dated 20 May 2002 "On amending certain legal acts of the National Bank of Ukraine".

this is stipulated by "bilateral agreements between central banks or corresponding banking supervision agencies" of Ukraine and the country where the subsidiary is located.

Concurrently, under the pretext of the need to abide by FATF requirements, over H1'02 the government adopted a number of decisions aimed at strengthening control over financial transactions which cannot actually be used for money laundering[64] (in particular, tax payment). Therefore, based on the criteria for classifying financial transactions as suspicious and uncommon that were specified by the Cabinet of Ministers in May 2002, transactions not related to money laundering can indeed fall under this category. These would include, for instance, transactions violating legislatively stipulated terms for settlements on export/import operations or contractual transactions that raise doubts as to their lawfulness. Nonetheless, a Decision of the Pechersk District Court of the City of Kyiv dated 23 September 2002 ordered the Cabinet of Ministers to revoke its resolution No. 700 "On setting criteria for classifying financial transactions as dubious and uncommon"; this, however, has not been done yet.

Despite these measures undertaken, the FATF recognised Ukraine as a country not cooperating in the sphere of money laundering. We believe that this was due to: (1) the sluggish reaction of the government and the Verkhovna Rada of Ukraine to FATF requirements; and (2) the negative image of Ukraine in the world. The FATF suggested that member countries take the following measures when working with Ukrainian companies and individuals:

- carry out a mandatory identity check on clients before establishing business relations;
- increase control over reporting on transactions with said persons;
- submit detailed inquiries about the activity of Ukrainian banks if they open subsidiaries, affiliates, or representative offices abroad;
- warn all partners, particularly in non-financial sectors, about the high risk of money laundering by clients from Ukraine.

In our opinion, these measures will not significantly worsen conditions for conducting business, given the willingness of the banking system to take the additional costs upon itself of servicing financial flows.

[64] According to universal practice, unpaid taxes are not considered dirty money, while proceeds from trafficking drugs, arms, and people do fall under this category. The extant Ukrainian legislation is also guided by this interpretation. However, the Cabinet of Ministers, when submitting the draft Law of Ukraine "On the prevention and counteraction of legalisation (laundering) of incomes acquired by criminal means" for first reading to the Verkhovna Rada, suggested that money obtained as a result of "committing a crime or actions aimed at concealing sources of such money's origin"—in particular, unpaid taxes—be considered dirty. During the debate of the draft law in the parliament, this statement was deleted.

Agriculture

The agricultural policy pursued by Ukraine's government has two aims: (1) transforming land into an effective market tool; and (2) stimulating agricultural production. The Land Code was the most important legislative act adopted in agriculture over the past four quarters; however, the promulgation of numerous by-laws required by the code is overdue. Key drawbacks of new legal acts aimed at stimulating agriculture are their declarative nature and anti-market orientation

Exercising land ownership rights

The Land Code was the most important agricultural legislative act passed by the Verkhovna Rada over the research period.[65] The objective of the Land Code and related land legislation is to regulate land relations in order to secure the land ownership rights of individuals, legal entities, territorial communities, and the government, as well as rational land usage and protection. Its adoption lays the foundation for creating a free land market, which will in turn facilitate the gradual transition of land plots to effective owners. Legislative affirmation of the right to private land ownership is expected to minimise the likelihood of reversal of reforms in agriculture.

The concluding provisions of the code include a list of legal acts which were to be devised by the Cabinet of Ministers within six months after the publication of the code. The list of these documents, their role in the resolution of agricultural problems, implementation mechanisms, and comments on them, are given in Table 3.

As of 30 November 2002, the Cabinet of Ministers failed to produce a significant part of the normative-legal acts envisaged by the Land Code. This delay may lead to the fact that by 2005 (when the moratorium on agricultural land sales is due to expire) appropriate conditions for free land sales in Ukraine will not have been created.

Stimulation of agricultural development

Unlike other types of economic activity, agricultural production is very dependent on weather conditions and natural disasters, which are difficult to predict and control. The government creates mechanisms to prevent drastic fluctuations in farm incomes, since such fluctuations can ruin a large number of enterprises at once. However, excessive government interference in the regulation of agricultural production saps its efficiency, tampers with market mechanisms, and distorts prices. Therefore, we believe that the government's key task is to create an adequate safety net that would not foster excessive dependence on government support.

Over the research period, several normative documents were adopted that set forth implementation mechanisms for measures

[65] The Land Code was approved on 25 October 2001.

Table 3. Measures envisaged in the Land Code that facilitate land reforms in Ukraine

Measure	Purpose of the measure	Legislative acts aimed at fulfiling the measure	Comments/additional information
Development of a methodology for monetary (especially expert) land assessment	Determining the market value of land plots for concluding civil and legal agreements and land sales on a competitive basis	Cabinet of Ministers of Ukraine resolution dated 11 October 2002 "On the expert monetary assessment of land plots"	Until 1 January 2005 sales of agricultural land are prohibited, therefore this mechanism will not be activated till then
Allocation of land plots in the field and registration of ownership rights for them	Setting the area, location, and demarcation of land plots and the ownership rights for them, which is an essential condition when concluding civil purchase-and-sale agreements of land plots on a competitive basis	Draft Law of Ukraine dated 29 June 1999 "On the State Land Cadastre"[66] Draft Law of Ukraine dated 23 October 2002 "On the land management system"	
Establishing the format for "state acts for the right of ownership over land plots" [land titles] and for the right of perpetual usage of land plots	Unification of documents confirming the land ownership right and the right of perpetual usage	Cabinet of Ministers of Ukraine resolution dated 2 April 2002 "On approving the format for state acts of ownership rights and the rights of permanent usage of land plots"	The act is issued after the land plot has been demarcated in the field. Land titles in the old format, which were handed out to about 40% of certificate owners, remain in effect and are subject to replacement only on a voluntary basis[67]
Ensuring the balanced development of land usage	Rational land usage and protection, support for a beneficial environmental situation, and amelioration of natural landscapes	Draft Law of Ukraine dated 23 October 2002 "On the land management system" Draft Law of Ukraine dated 17 June 2002 "On land protection"	

[66] No modifications to this draft law were made over the past three years.

[67] Agricultural landowners received the majority of currently existing land titles during 2001, when the share of rural residents that exchanged their [land share] certificates for the titles increased from 8.7% to 30.4%. After the establishment of a unified format for these acts, the share of the rural population obtaining acts grew only slightly–from 40% (April 2002) to 43.5% (December 2002).

Measure	Purpose of the measure	Legislative acts aimed at fulfiling the measure	Comments/additional information
Creation of a land (mortgage) bank	Loans to agricultural producers against the collateral of land and other immovable property	Draft Law of Ukraine "On the Land (Mortgage) Bank" (versions dated 19 March 1999 and 6 July 2000) Draft Law of Ukraine dated 14 January 2000 "On mortgage" Cabinet of Ministers of Ukraine directive dated 11 July 2002 "On creating the Coordination Council on Creating a Mortgage Lending System"	Free land sales are prohibited till 1 January 2005, hence, till this time land cannot be an effective collateral instrument
Granting the right of private ownership over land to legal entities and the right to include it in share capital	Private ownership fosters more effective ownership (compared to collective) and land allocation; land becomes capital	Necessity of implementation of a new Civil Code	Prohibition to acquire possession of more than 100 hectares till 2010 (does not apply to inherited plots)

Source: International Centre for Policy Studies.

envisaged in the Law of Ukraine "On promoting the development of agriculture in 2001–2004".[68]

Mandatory crop insurance

On 11 July 2002, the Cabinet of Ministers of Ukraine issued a resolution introducing mandatory crop insurance;[69] this document became a by-law to the Law of Ukraine "On insurance" dated 4 October 2001, and stipulates that the government must pay not less than 50% of insurance payments.

Insurance of crops is a universal practice, which helps farmers to manage their risks and reduces the probability of devastating impact of unfavourable weather conditions, natural disasters, etc. However, in most countries crop insurance is voluntary.[70] In our opinion, mandatory insurance in agriculture has the following drawbacks:

- enterprises have less incentive to independently diversify their risks and invest in agri-technologies, which could help

[68] For more details on this law, see **Policy Studies**, No. 16 (October 2001), pp. 41–42.

[69] See the Cabinet of Ministers of Ukraine resolution dated 11 July 2002 "On approval of the Procedure and rules for effecting mandatory insurance of the agricultural harvest and perennial plantings by state agricultural enterprises, and of grain crop and sugar beet harvests by agricultural enterprises of all forms of ownership".

[70] See **Quarterly Predictions**, No. 20 (July 2002), pp. 45–47.

reduce the dependency of crops on weather conditions;

- agricultural enterprises can interpret mandatory insurance as an additional tax depleting operating funds;
- enterprises which are vertically integrated, and thus are able to independently diversify their risks, will incur additional expenditures on mandatory insurance.

Moreover, the breakdown of maximum rates for insurance tariffs under the mandatory crop insurance agreements proposed in the resolution is poorly diversified; hence, it disregards certain differences inherent in the risks.[71]

Concurrently, we believe that the measures envisaged in the resolution will not have any dramatic impact upon Ukrainian agriculture in the next few years, due to the following circumstances:

- the number of enterprises insuring their crops in upcoming years is unlikely to change compared to previous years, since the resolution envisages no control mechanisms over this process;
- insurance companies will not offer crop insurance services, due to the high risk of not receiving compensation from the budget.[72]

We believe that in order to galvanise agriculture, the government should stimulate the use of instruments which do not require any or require insignificant budget assignations, and do not tamper with market mechanisms such as voluntary insurance, production diversification, vertical integration, creation of mutual insurance funds, hedging with futures, and options against risks.

Grain market

The Law of Ukraine "On grain and the grain market in Ukraine", adopted by the Verkhovna Rada on 4 July 2002, targets to resolve the problem of the sharp fall in prices triggered by the simultaneous supply of huge grain parties to the market. In order to maintain stable grain prices, the law proposes implementing mechanisms of pledge and intervention purchases. Nevertheless, in our opinion the new law has the following flaws:

- leaves open the issue of what to do with the unredeemed pledged grain;
- does not set forth any procedures for selecting the banks which would grant loans under the pledged procurements,[73] which is conducive to corruption;
- the appointment of state agents to conduct intervention purchases and facilitate pledged grain purchases and the export/import of grain and grain products envisages that only state enterprises or economic entities with a state share of no less than 75% in its share capital can act as agents, which will significantly limit the choice of agents.

We believe that the new law will not have an immediate dramatic effect upon the grain market. The number of farmers who will decide to pledge their grain or sell it to intervention purchase agents will be trifling, due to the following factors:

- the draft 2003 budget has no line items for financing pledged and intervention grain purchases;
- even if the government finances the pledged purchases, narrowly specialised

[71] In 2002, the USDA's Risk Management Agency offered farmers polices for the voluntary insurance of more than 100 crops. Moreover, the polices differed in the share of the insured harvest.

[72] The draft 2003 State Budget does not envisage any allocations for reimbursing insurance payments.

[73] Pursuant to the law, the procedure is stipulated by the Cabinet of Ministers of Ukraine.

smallholders will not take advantage of this opportunity, since grain prices will be half the amount of the market price,[74] while they will not have any new operating funds to buy out the pledged grain when the price climbs back up;

- it is unlikely that the state will be able to actively use intervention grain purchases, since they demand far more substantial budget funds than pledged ones (plus, this mechanism can only work if the intervention price of grain purchases is higher than the market one).

Protection of the rights to crop varieties

The selection, planting, and reproduction of new sorts of agricultural crops is an important factor in increasing the efficiency of agriculture and its sustainable development. One of the areas of government activity stipulated in the Law of Ukraine "On promoting the development of agriculture in 2001–2004" envisages measures aimed at supporting scientific research in the sector. On 17 January 2002, the Verkhovna Rada of Ukraine passed a new redaction of the Law of Ukraine "On protection of the rights to plant varieties". The law aims to regulate relations in the sphere of acquiring rights to plant varieties, their realisation and protection, and also takes into account Ukraine's international obligations, specifically, those in the International Convention for the Protection of New Varieties of Plants (UPOV–Union internationale pour la protection des obtentions végétales).

The law defines two types of rights–personal non-property author's rights and property rights of plant variety owners. Property rights for varieties are certified with a patent, and can be subject to pledging and entered into the share fund of legal entities. Patents are valid for 35 years for trees, shrubbery, and grapes, and 30 years for varieties of other plants. Patent owners can grant permission (open license) to other persons, or either exclusive or non-exclusive licenses for using varieties; in this case, the levy to enforce the validity of the variety owner's exclusive rights is halved.

The key advantage of the law is that it provides for the development of the selection field in Ukraine without applying significant additional budget funds. However, we believe that the mechanisms proposed in the adopted law will not create any extra stimuli for agricultural selection, due to the following circumstances:

- The patent procedure is rather cumbersome and lengthy. In particular, new varieties of most plants are subject to government testing. Thus, registration and obtaining a patent lasts several years;
- The group of potential payers for using licensed varieties is small, since those who grow some varieties in their gardens for private consumption do not have to pay the variety owners, and neither do the owners of subsidiary holdings who propagate these varieties on an area not exceeding that which is required to yield 92 tons of soft wheat.[75]

Ownership rights of the rural population

Landownership reform requires the settlement of issues surrounding property rights over non-land agricultural objects. Ukraine still does not have any cogent policy on the

[74] The mechanism of pledged purchases envisages state grain procurements for a certain period at a certain minimal price, stipulated by the Cabinet of Ministers of Ukraine resolution dated 29 April 2002 "On determining pledged prices and financial support for pledged grain purchases" and makes up 50% of the price in the agricultural exchange market at the moment of signing of agreements on pledged procurements.

[75] In Ukraine, the average wheat yield over 2001–2002 was to 28.4 centners per hectare. Thus, the law exempts smallholders who plant this crop on a territory of up to 32 hectares from paying compensation to the owner of the given variety.

distribution of property formerly belonging to *kolkhozes* (Soviet collective agricultural enterprises), or on the stimulation of effective property usage. The Decree of the President of Ukraine dated 27 August 2002 "On additional measures to increase the level of protection of property rights of the rural population" sets benchmarks along which to develop the legislative base in this area.

Under the decree, within six months of its promulgation, the Cabinet of Ministers should undertake measures to implement the following mechanisms:

- acquisition of property shares by agricultural enterprises for buyout;
- sale of property shares on a competitive basis;
- exercise by property share owners of their rights to obtain their shares in kind; usage of reclamation systems and perennial plantings that belonged to *kolkhozes* which were either liquidated or reorganised.

As of 30 November 2002, the Cabinet of Ministers did not issue a single document to implement the above measures, which means that any changes in ownership rights over non-land agricultural property will be unscheduled. The more rapid pace of reforms in landownership rights compared to the analogous reforms concerning objects located on said land could trigger imbalances which would undermine any increases in effectiveness of sectoral functioning.

Communications

Consumers expect communications operators to provide high-quality services at non-monopoly prices, which is achievable under conditions of competition. Concurrently, there are grounds for government intervention, due to: (1) the possibility of the dominant operator abusing its monopoly status; and (2) the necessity to supply communications services to vulnerable societal subgroups and inhabitants of remote and hard-to-access territories. Over the research period, a new draft Law of Ukraine "On telecommunications" was developed, and the Law of Ukraine "On postal communications" was approved

The government's policy goal in the communications sphere is to satisfy public demand for quality communications services. Among the instruments facilitating the attainment of this goal are: (1) competition, which should ensure the highest quality in profitable market segments; and (2) financing mechanisms that would guarantee the delivery of services in loss-making market segments.

The Law of Ukraine "On communications" dated 16 May 1995 has liberalised the communications market in Ukraine. As of 1 October 2002, pursuant to the law, 598 licenses for local communications were issued, as well as 9 long-distance and international communications, and 7 cellular licenses. In addition, the market for Internet services and IP-telephony rapidly developed.

Nevertheless, the Law of Ukraine "On communications" has failed to resolve the following problems:

- No financing mechanism has been established for service delivery in loss-making market segments, which include the following: (1) geographically remote and hard-to-access territories; and (2) the poor, people with special needs (pensioners, disabled), etc.;
- Horizontal relations between operators have not been regulated. Although the law did regulate relations between operators and the government (through licensing procedures), it did not stipulate any detailed norms for the interconnection of operators' networks, which is the key mechanism for ensuring market competition.

Telecommunications

The abovementioned flaws in the Law "On communications" have had to negative consequences, most perceptibly in the telecommunications sector. For example, the commercial and social functions of the Ukrtelekom OJSC national telecommunications operator were not separated. As in Soviet times, Ukrtelekom continues to finance the execution of the state's social obligations from its own funds, but receives no compensations from the budget. Specifically, Ukrtelekom has the following expenditures in this area:

- Losses from providing telephone services in rural administrative regions;
- Losses from connecting privileged groups of subscribers and from discount subscriptions of certain consumer groups. The State Communications Committee (Derzhkomzviazok) calculated that the volume of benefits for telecommunications services declared in extant legislation totaled 110 million hryvnias in 2001, but that State Budget spending on communications, which

includes compensation to Ukrtelekom for the benefits it provided, was executed to 63.5% of the planned 26 million hryvnias;

- Failure of budget-sector institutions to pay for consumed services, with accumulated debts to Ukrtelekom for communications services provided in 2001 totaling 606.6 million hryvnias, accounting for 15% of the company's revenues. The biggest share of the accounts receivable (43%) was made up of non-payments by budget-sector institutions.

Combining the commercial and social functions of the Ukrtelekom OJSC warps market competition, in view of the following circumstances:

- Due to the expenditures on social goals, Ukrtelekom is limited in its possibilities to invest in network updating, and thus is incapable of competing with new operators. Support for the dilapidated analog network requires constant increases in current expenditures, and thus the company cannot save money for the development of a digital network, which requires sizable initial investments. In addition, intensifying competition in the market for international communications does not allow to offset losses from the delivery of local communications services by cross-subsidising;
- In order to offset its losses, Ukrtelekom OJSC is forced to inflate interconnection fees[76] and restrict network access for private operators. Such practices are induced by the lack of interconnection regulations.

If a mechanism for financing social needs is not created, and relations among operators are not regulated, this will lead to: (1) further exacerbated conflicts between Ukrtelekom and private operators; (2) sluggish development of the telecommunications network; and (3) slow pace of expansion of telephone penetration. Thus, all market players should be interested in the adoption of the new law "On telecommunications".

The experience of member countries of the European Union offers the following key mechanisms for regulating telecommunications:

- Establishment of a national regulatory agency, which would, in particular, act as an independent party in the settlement of disputes between operators;
- Putting in order the tariffs of the dominant operator, in order to ward off abuses of its monopoly status in the market;
- Establishment of a fund for universally accessible services, from which operators' losses from the provision said services will be offset. All operators shall make contributions to this fund, whereas the money shall be allocated based on tenders;
- Regulation of operators' interconnections, in order to guarantee access of new operators to markets and prevent socially unproductive investments in the construction of parallel networks. Interconnection fees should take into account the dominant operator's expenditures on network maintenance, but should not be discriminatory towards new operators;
- Introduction of licensing procedures that would not poise excessive barriers to market entry.

The Verkhovna Rada registered a draft Law of Ukraine "On telecommunications", submitted by the MPs Yuri Lutsenko and Valeri Pustovoitenko. This draft law is an attempt to bring the functioning of the telecommunications sector in Ukraine into line with European Union directives. Key points of the draft law are given in Table 4.

[76] Interconnection prices are inflated because the Ukrtelekom OJSC sets unjustified requirements for the construction of network components at operators' expense, or proposes that operators purchase options, the price of which equals their construction cost.

An important innovation of the draft law is that terms of operators' network interconnections are brought into line with the recommendations of the European Union. However, the success of this innovation will greatly depend on the development of the necessary normative acts, particularly the rules for and mandatory requirements of interconnection agreements.

Despite the above, the draft Law of Ukraine "On telecommunications" submitted by Messrs Lutsenko and Pustovoitenko contains significant flaws:

- No procedures or criteria are established for the approval of decisions of the regulatory agency (the National Commission on Telecommunications Regulation), which brings a great risk that the regulatory agency will be manipulated by particular interest groups to implement decisions convenient for this group;
- Financing universal access at the cost of tax benefits to operators providing universal services will warp competition and is not in line with tax policy principles. Firstly, the draft law does not envisage any bidding procedures for competitive selection of the operator which will provide universal services; hence, there is no mechanism for selecting the most efficient projects. Thus, the budget will sustain unproductive losses from extending the benefits. Secondly, with the lack of bidding procedures, the benefit system will prompt abuses and will become a way of tax evasion. If the draft law is passed, the Ukrtelekom OJSC would actually become the biggest recipient of tax benefits;
- The proposed draft law places licensing of telecommunications services beyond the purview the Law of Ukraine "On licensing certain types of economic activity" (see **Regulation of economic activity**). In our opinion, a broad list of types of individual licenses is unjustified. Firstly, such a complex system would heap more operating costs upon communications enterprises. To be able to start their activity, operators would have to pay at least twice—for general permission and for an individual license to provide certain telecommunications services. Secondly, licensing the right to construction on privileged terms would distort competition and lead to abuses. Thirdly, obligations to provide universal services can be stipulated in agreements between operators and the regulatory agency, instead of issuing licenses;
- The draft law includes many references to non-existent legislation.

Thus, the submitted draft law does not resolve the problem of combining commercial and social functions. Under this draft, Ukrtelekom OJSC would be extended tax benefits, but would have no stimuli to devise and implement a commercial strategy. Furthermore, the vagueness of norms in the draft law would create conditions for abuse and increase providers' operating expenditures, as well as administration expenditures by government bodies.

Table 4. Key points of the draft Law of Ukraine "On telecommunications"

Regulation mechanisms	Proposals of the draft Law of Ukraine "On telecommunications"
Creation of a national regulatory body	The regulatory body is the National Commission on Telecommunications Regulation (NCTR), which is a central agency of the executive arm of government, assigned special status, and includes five members appointed by the Verkhovna Rada. Financed from the budget, NCTR activities are assured openness

Regulation mechanisms	Proposals of the draft Law of Ukraine "On telecommunications"
	by means of unrestricted public participation in the discussion of all issues (except confidential ones), and by the publication of all approved decisions. As part of the NCTR, a consultative-advisory body is formed—the Telecommunications Council, whose members are approved by the NCTR jointly with the State Communications Committee. Its functions, in particular, include the coordination of drafts of legal acts in the telecommunications domain
Tariff regulation	The NCTR regulates tariffs, which include: (1) tariffs for universal services, and (2) tariffs for connection to the networks of operators which are monopolists (dominators) in the telecommunications market
Ensuring universal access	Universal services can be rendered by any operator, as long as they have an individual license for engaging in this type of activity. In case of insufficient satisfaction of consumer demand for universal services, the NCTR is entitled to oblige monopolist (dominant) operators to develop and provide such services, and to grant them licenses for special obligations. Financing universal access is done by providing the following tax benefits to operators: – a 50% reduction in the corporate profit tax and VAT rates from the delivery of universal services; – a 50% reduction of the land tax rate; – exemption from payment of import duty and VAT upon the imported equipment necessary for the delivery of universal services; – accelerated depreciation (at 20% rate) of the principal assets of the 3rd group. Funds released as a result of the granted benefits are to be used exclusively to finance universal services
Interconnection regulation	Interconnection of telecommunications networks is done on contractual terms, in line with the "Rules for Interconnection of Telecommunications Networks of General and/or Restricted Access" and with the "Mandatory Requirements for Interconnection Agreements", approved by the NCTR. Interconnection agreements between parties can give the NCTR grounds to intervene, which can be done at any time upon the request of either party, or upon its own initiative, in the sphere of telecommunications network interconnections. Such authorities are granted in order to ensure effective competition and establishment of non-discriminatory, fair, and acceptable conditions for both parties—which are also the most beneficial for consumers. Arguments between operators are considered by the NCTR. Its decisions are binding upon the participants of telecommunications network interconnections, which can only be repealed by court ruling. The fee for access to the dominant operator's telecommunications networks is fixed by the NCTR. The monopolist undertakes to do the following: 1) set suitable (non-discriminatory) terms for other operators which provide or intend to provide telecommunications services to connect to their telecommunications networks; 2) annually submit proposals for telecommunications network interconnections for approval by the NCTR, which approves and publishes a catalogue of these proposals
Licensing	Activity in Ukraine's telecommunications sector can be performed on the basis of general permissions and individual licenses. All types of activity in the telecommunications sphere require general permission. Individual licenses are issued additionally in the following cases: 1) providing telecommunications services of fixed-line telephone communications (local, long-distance, international, IP-telephony), mobile communications, paging

Regulation mechanisms	Proposals of the draft Law of Ukraine "On telecommunications"
	communications, and TV and radio broadcasting (licenses for engaging in the activity); 2) allocating some share of the radio frequency resource to individual license owners (licenses for limited resource usage); 3) conferring individual license holders the right to build telecommunications networks on privileged terms (licenses for special rights); 4) imposing special duties regarding universal telecommunications services and/or public networks upon the monopolist (dominant) operator (licenses for special obligations). The law sets the procedure for issuing general permissions and individual licenses. In addition, the NCTR can set additional terms for individual licenses (whose fees are set by the Cabinet of Ministers of Ukraine)

Source: International Centre for Policy Studies.

Postal communications

On 4 October 2001, the Verkhovna Rada adopted the Law of Ukraine "On postal communications". This is a framework law, which sets forth the overall principles for regulation in the postal communications sector. Specifically, the law outlines the powers of executive government bodies in this field, as well as the rights and obligations of operators.

An innovation in this law is the introduction of the concept of universal (universally accessible) services—namely, postal communications services of public use at an established level of quality, offered to all users across the whole territory of Ukraine at state-regulated tariffs. The list of universal services is determined by the Cabinet of Ministers, while tariffs are regulated by the National Commission for Telecommunications Regulation. The national operator of postal services is charged with providing universal services, while losses are financed from state funds.

On the one hand, the law distinguishes between the commercial and social functions of the national postal communications operator. On the other hand, it does not envisage any mechanism to stimulate increased effectiveness of the universal services.

Since the Law of Ukraine "On postal communications" is mostly composed of framework provisions, it does not exert any direct effect. In order to ensure its implementation, additional requirements need to be fulfilled; specifically, the National Commission for Telecommunications Regulation should be created, a number of normative acts should be adopted at the level of the Cabinet of Ministers of Ukraine, and budget funds should be allocated to offset the losses of the national operator from providing universal (universally accessible) services.

List of evaluated legislation

Document	Title	Adoption date	No.
Ownership relations			
Law of Ukraine	"On declaring a moratorium on forced property sales"	dated 29.11.2001	No. 2864-III
Law of Ukraine	"On amending the Law of Ukraine 'On the list of objects of state ownership rights that are not subject to privatisation'"	dated 13.12.2001	No. 2889-III, No. 2990-III
Law of Ukraine	"On amending Article 43 of the Law of Ukraine 'On economic associations'"	dated 10.01.2002	No. 2916-III
Law of Ukraine	"On amending the Law of Ukraine 'On the list of objects of state ownership rights that are not subject to privatisation'"	dated 7.02.2002	No. 3051-III, No. 3052-III
Law of Ukraine	"On amending the Law of Ukraine 'On restoring debtors' solvency or declaring them bankrupt'"	dated 7.03.2002	No. 3088-III
Law of Ukraine	"On amending the Law of Ukraine 'On economic companies'"	dated 7.03.2002	No. 3095-III
Presidential Decree	"On immediate measures to regulate the activities of state (national) joint-stock and holding companies"	dated 7.11.2001	No. 1049/2001
Presidential Decree	"On measures regarding the development of corporate governance in joint-stock companies"	dated 21.03.2002	No. 280/2002
Presidential Decree	"On additional measures to improve the activities of the State Commission on Securities and the Stock Market"	dated 25.09.2002	No. 861/2002
Cabinet of Ministers Resolution	"On the transfer of 100 percent of the shares of the Komsomolske Rudoupravlinnia open joint-stock company, which is part of the share capital of the Ukrrudprom State Joint-Stock Company, to the management of the Mariupol Illich Metallurgical Works open joint-stock company"	dated 1.03.2002	No. 231
Cabinet of Ministers Resolution	"On approving the Procedure for issuance, evaluation, acceptance, endorsement, and payment of bills of exchange issued by state enterprises and joint-stock companies with state shares in their share capital exceeding 50 percent"	dated 6.03.2002	No. 262

Cabinet of Ministers Resolution	"Certain issues concerning boosting the investment appeal of privatisation objects"	dated 23.10.2002	No. 1563
Cabinet of Ministers Resolution	"On the creation of the Coordination Council on Corporate Governance in Joint-stock Companies"	dated 16.11.2002	No. 1771
Cabinet of Ministers Directive	"On approving the lists of open joint-stock companies whose share packages are subject to sale in 2002"	dated 19.02.2002	No. 78-p
Cabinet of Ministers Directive	"On the execution summary for 2001 of the 'State Privatisation Program for 2000-2002' and objectives for privatisation in 2002"	dated 5.06.2002	No. 306-p
Judicial reform			
Law of Ukraine	"On the judiciary in Ukraine"	dated 7.02.2002	No. 3018-III
Presidential Decree	"On the State Judicial Administration of Ukraine"	dated 29.08.2002	No. 780/2002
Presidential Decree	"On the Appeals Court of Ukraine, the Cassation Court of Ukraine, and the Higher Administrative Court of Ukraine"	dated 1.10.2002	No. 889/2002
Presidential Decree	"On the number of judges in the Appeals Court of Ukraine, the Cassation Court of Ukraine, and the Higher Administrative Court of Ukraine"	dated 7.11.2002	No. 995/2002
Tax policy			
Law of Ukraine	"On amending certain legislative acts of Ukraine on the state support of the automobile manufacturing industry"	dated 15.11.2001	No. 2779-III
Law of Ukraine	"On amending certain laws of Ukraine in order to eliminate instances of tax and levy (mandatory payment) evasion by certain enterprises created with participation of foreign investors"	dated 20.12.2001	No. 2899-III
Law of Ukraine	"On fostering the development of domestic machine building for the agro-industrial complex"	dated 7.02.2002	No. 3023-III
Law of Ukraine	"On amending certain laws of Ukraine on the creation and functioning of special (free) economic zones and the implementation of special regimes of investment activity in priority development territories"	dated 7.02.2002	No. 3036-III
Law of Ukraine	"On innovation activity"	dated 4.07.2002	No. 40-IV

Law of Ukraine	"On amending certain laws of Ukraine pertaining to the taxation, production, and turnover of excisable goods"	dated 24.10.2002	No. 195-IV
Cabinet of Ministers Resolution	"On putting in order the reimbursement of value-added tax and budget settlements"	dated 26.09.2001	No. 1270
Cabinet of Ministers Resolution	"On measures to ensure the execution of the State Budget of Ukraine in Q1'02"	dated 10.01.2002	No. 21
Cabinet of Ministers Resolution	"On writing off the debts of the state budget on reimbursements of value-added tax accumulated as of 1 January 2001"	dated 1.03.2002	No. 244
Cabinet of Ministers Resolution	"On amending Cabinet of Ministers of Ukraine Resolution No. 225 dated 7 March 2001" ("On the maximum amount of actual expenditures for labour remuneration of hired employees, taxable incomes (profits), and aggregate taxable incomes (maximum sum of wages (incomes), from which insurance contributions (levies) to social funds are deducted")	dated 11.04.2002	No. 494
Order of the State Tax Administration	"On approving the tax explanation regarding the procedure for applying a zero rate of the value-added tax on goods sent (exported) outside the border of the customs territory of Ukraine"	dated 5.09.2002	No. 418
Regulation of economic activity			
Law of Ukraine	"On amending the Law of Ukraine 'On insurance'"	dated 4.10.2001	No. 2745-III
Law of Ukraine	"On the particularities of state regulation of the activity of business entities associated with the production, export, and import of discs for laser reading systems"	dated 17.01.2002	No. 2953-III
Law of Ukraine	"On higher education"	dated 17.01.2002	No. 2984-III
Law of Ukraine	"On amending certain legislative acts of Ukraine on wastes"	dated 7.03.2002	No. 3073-III
Law of Ukraine	"On amending Article 9 of the Law of Ukraine 'On licensing certain types of economic activity'"	dated 7.03.2002	No. 3077-III
Law of Ukraine	"On amending the Law of Ukraine 'On the quality and safety of foodstuffs and raw food materials'"	dated 24.10.2002	No. 191-IV

Presidential Decree	"On the State Committee of Ukraine on Technical Regulation and Consumer Policy"	dated 1.10.2002	No. 887/2002
Presidential Mandate	"Pursuant to the results of the All-Ukrainian Conference on the Development of Small and Medium Business held on 15 July 2002"	dated 29.07.2002	No. 1-1/966
Cabinet of Ministers Resolution	"On approving the Procedure for issue by the Cabinet of Ministers of Ukraine of permission for coordinated actions, and for the concentration of economic entities"	dated 28.02.2002	No. 219
Cabinet of Ministers Resolution	"On approving the lists of central executive government bodies charged with functions of technical regulation in designated spheres of activity and of developing technical regulations"	dated 13.03.2002	No. 288
Cabinet of Ministers Resolution	"On approving the Procedure for granting authorisation to certification agencies to conduct works on confirming compliance in legislatively regulated spheres"	dated 28.03.2002	No. 376
Cabinet of Ministers Resolution	"On approving the Rules for calculating the cost of works on confirming compliance in legislatively regulated spheres"	dated 11.04.2002	No. 485
Cabinet of Ministers Resolution	"On amending Cabinet of Ministers of Ukraine resolution No. 756 dated 4 July 2001" ("On approving the list of documents attached to applications for issuing licenses for specific types of economic activity")	dated 17.05.2002	No. 638
Cabinet of Ministers Resolution	"On amending Cabinet of Ministers of Ukraine resolution No. 756 dated 4 July 2001" ("On approving the list of documents attached to applications for issuing licenses for specific types of economic activity")	dated 17.05.2002	No. 645
Cabinet of Ministers Resolution	"On approving the lists of documents and commodity groups subject to protection with holographic elements"	dated 5.07.2002	No. 932
Cabinet of Ministers Resolution	"On amending the list of documents attached to applications for issuing licenses for specific types of economic activity"	dated 17.08.2002	No. 1147
Cabinet of Ministers Resolution	"On amending the list of documents attached to applications for issuing licenses for specific types of economic activity"	dated 16.11.2002	No. 1762

Cabinet of Ministers Directive	"On studying the situation in foods and non-foods sales markets"	dated 16.11.2002	No. 652-p
Cabinet of Ministers Directive	"On measures towards the execution of the National Program for Small Business Development in Ukraine for 2003"	dated 16.11.2002	No. 654-p
Directive of the Antimonopoly Committee of Ukraine	"On the Regulations for the procedures for conducting checks compliance with legislation on the protection of economic competition"	dated 25.12.2001	No. 182-p
Order of the Ministry of Economy and European Integration, the Ministry of Internal Affairs, the State Tax Administration, and the State Committee on Standardisation, Metrology, and Certification	"On approving the Rules for trading in markets"	dated 26.02.2002	No. 57/188/84/105
Order of the Ministry of Justice	"On amending certain legal acts of the Ministry of Justice of Ukraine on the sale of arrested property"	dated 21.10.2002	No. 91/5
Open economy			
Law of Ukraine	"On amending certain legislative acts of Ukraine on state support for the automobile manufacturing industry"	dated 15.11.2001	No. 2779-III
Law of Ukraine	"On the particularities of state regulation of the activities of business entities associated with the production, export, and import of discs for laser reading systems"	dated 17.01.2002	No. 2953-III
Law of Ukraine	"Customs Code of Ukraine"	dated 11.07.2002	No. 92-IV
Law of Ukraine	"On the exit (export) duty on waste ferroproducts and ferrous scrap metal"	dated 24.10.2002	No. 216-IV
Presidential Decree	"On the action program for completing Ukraine's accession to the World Trade Organisation"	dated 5.02.2002	No. 104/2002
Cabinet of Ministers Resolution	"On amending the Procedure for issuing employment permits to foreigners and stateless individuals in Ukraine"	dated 17.05.2002	No. 649

Financial Sector			
Law of Ukraine	"On the Fund for Guaranteeing Individual Deposits"	dated 20.09.2001	No. 2740-III
Law of Ukraine	"On amending the Law of Ukraine 'On insurance'"	dated 4.10.2001	No. 2745-III
Law of Ukraine	"On amending the Code of Ukraine on Administrative Offences with regard to establishing responsibility for violating banking legislation"	dated 4.10.2001	No. 2747-III
Law of Ukraine	"On credit unions"	dated 20.12.2001	No. 2908-III
Law of Ukraine	"On putting in order the debts owing on the individual deposits of depositors and other creditors of the Ukraina Joint-Stock Commercial Agroindustrial Bank"	dated 7.03.2002	No. 3097-III
Law of Ukraine	"On preventing and counteracting the legalisation (laundering) of incomes acquired by criminal means"	dated 28.11.2002	No. 249-IV
Presidential Decree	"On the State Commission for Regulating the Financial Services Market in Ukraine"	dated 11.12.2002	No. 1153/2002
Cabinet of Ministers Resolution	"On creating a State Department for Financial Monitoring"	dated 10.01.2002	No. 35
Cabinet of Ministers Resolution	"On approving the Regulations on the State Department for Financial Monitoring"	dated 18.02.2002	No. 194
Cabinet of Ministers Resolution	"On defining the criteria for classifying financial transactions as dubious or uncommon"	dated 29.05.2002	No. 700
Cabinet of Ministers and NBU Resolution	"On approving the Regulations on the Fund for Guaranteeing Individual Deposits"	dated 30.08.2002	No. 1301/268
Resolution of the NBU Board	"On approving the Regulations on the procedure for opening subsidiary banks, affiliates, or representative offices of Ukrainian banks on the territory of other states, and particulars concerning their closing and supervision thereof"	dated 30.01.2002	No. 45
Resolution of the NBU Board	"On amending certain normative-legal acts of the National Bank of Ukraine"	dated 20.05.2002	No. 186
Resolution of the NBU Board	"On approving the Regulations on the procedure for granting general licenses to non-banking financial institutions for engaging in hard-currency transactions"	dated 9.08.2002	No. 297

Order of the State Property Fund, Decision of the State Commission on Securities and the Stock Market, and Directive of the Antimonopoly Committee	"On approving amendments to the Regulations on the procedure for the sale at stock exchanges of share packages of state-owned open joint-stock companies, approved by a joint order of the State Property Fund of Ukraine, the State Commission on Securities and the Stock Market, and the Antimonopoly Committee of Ukraine No. 2141/297/9 dated 16.11.98"	dated 31.01.2002	No. 189/72/96-p
Decision of the State Commission on Securities and the Stock Market	"On approving the Regulations on the requirements to contracts for providing services of sales and buyout of securities of joint investment institutes (mutual funds)"	dated 11.01.2002	No. 11
Decision of the State Commission on Securities and the Stock Market	"On approving the Regulations on the assets composition and structure of joint investment institutes (mutual funds)"	dated 11.01.2002	No. 12
Decision of the State Commission on Securities and the Stock Market	"On approving the Regulations authorising asset management companies to perform professional asset management of joint investment institutes (mutual funds)"	dated 11.01.2002	No. 13
Decision of the State Commission on Securities and the Stock Market	"On approving the Regulations on the expenditure composition and structure refunded from the assets of joint investment institutes (mutual funds)"	dated 2.07.2002	No. 196
Decision of the State Commission on Securities and the Stock Market	"On approving the Regulations on the procedure for calculating the cost of net assets of joint investment institutes (share and corporate investment funds)"	dated 2.07.2002	No. 201
Decision of the administrative board of the Fund for Guaranteeing Individual Deposits	"On approving the Regulations on the procedure for reimbursing individual deposits by the Fund for Guaranteeing Individual Deposits"	dated 12.02.2002	No. 2
Decision of the administrative board of the Fund for Guaranteeing Individual Deposits	"On approving the Regulations on the procedure for maintaining the Registry of member banks (temporary members) of the Fund for Guaranteeing Individual Deposits"	dated 12.02.2002	No. 3
Agriculture			
Law of Ukraine	"Land Code of Ukraine"	dated 25.10.2001	No. 2768-III
Law of Ukraine	"On amending the Law of Ukraine 'On protecting the rights to crop varieties'"	dated 17.01.2002	No. 2986-III

Law of Ukraine	"On grain and the grain market in Ukraine"	dated 4.07.2002	No. 37-IV
Presidential Decree	"On additional measures to increase the level of protection of property rights of the rural population"	dated 27.08.2002	No. 774/2002
Cabinet of Ministers Resolution	"On approving the formats for state acts for right of land plot ownership and for state acts for the right of perpetual usage of land plots"	dated 2.04.2002	No. 449
Cabinet of Ministers Resolution	"On determining pledged prices and financial support for pledged grain procurements"	dated 29.04.2002	No. 590
Cabinet of Ministers Resolution	"On approving the Procedure and rules for effecting mandatory insurance of agricultural crops and crops of perennial plantings by state agricultural enterprises, as well as harvests of grain and sugar beets by agricultural enterprises of all forms of ownership"	dated 11.07.2002	No. 1000
Cabinet of Ministers Resolution	"On the expert monetary assessment of land plots"	dated 11.10.2002	No. 1531
Cabinet of Ministers Directive	"On creating the Coordination Council on Establishing a Mortgage Lending System"	dated 11.07.2002	No. 384-p
Communications			
Law of Ukraine	"On postal communications"	dated 4.10.2001	No. 2759-III

The journal **POLICY STUDIES** was established by the International Centre for Policy Studies in January 1999. **POLICY STUDIES** presents the results of policy research carried out by ICPS consultants, partners, and other think tanks in Ukraine and the intellectual community.

This publication is supported by a contract from the Center for International Private Enterprise in Washington, D.C.

Editor of **POLICY STUDIES**: Olha Pindiuk
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Our special thanks for assistance and advice go to the staff and consultants of ICPS.

Printed in Ukraine by Pekotoff-print

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